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SOUTHERN AFRICA

Fifth Edition

Guide to Business Law

COMMERCIAL LAW

SHAWN KOPEL

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http://www.oxford.co.za/catalogue/book/9780195996784

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Preface

‘I bought a brand new washing machine and I have named it after you, Shawn,’ a student named Joanne told me proudly in class with a wide smile on her face.

‘And to what do I owe this huge honour?’ I asked her, being both flattered at the thought a student would appreciate my classes so kindly, but at the same time feeling somewhat disappointed that I had only made the grade as a kitchen appliance.

‘I made a lot of money selling the notes you hand out in class to law students at other campuses. They are very good notes!’ she answered.

And so, with the dawning realisation that my students were getting very much more from my lecture notes than I had anticipated when I had started to hand copies out at the end of each class, began the journey whose destination you are holding in your hands, this textbook.

It all began as an ugly duckling with a working title called: ‘I haven’t studied and now I must pass my law exam.’ I don’t know of many students who would not open a book with that title, but simply mentioning the idea makes the publishers shudder and groan. (Rather loudly, actually.)

To everyone’s pleasant surprise, the first edition of the book broke even and survived, despite the competition from rival titles in the market. Fifteen years, five editions and multiple reprints later, the ugly duckling has grown up.

I am immensely grateful to students at so many campuses who realised it was smarter to buy the book than to pay for regular upgrades to Joanne’s kitchen, and to all those who friend me on Facebook. I love the idea that there is a part of me on bookshelves in homes and offices across the land, and not just in a student’s kitchen.

Talking about kitchens, I got the last laugh. I named my car after a student. Guess what I called it?

This book is dedicated with gratitude to kitchen appliances everywhere, and the amazingly talented friends, work colleagues and the occasional bosses who have inspired me and helped me along the way. Carol Bebbington, Lorenzo Bruttomesso, Karin Harris and Cheyenne Von-Zieden deserve a special mention, as do Simon Beach and Helen Barnes.

My special thanks also to the production, sales and editorial teams at Oxford University Press. Please visit the OUP companion website at http://www.oxford.co.za/catalogue/book/9780195996784 for additional chapters free to download, and find out more about me on my Facebook page.

The law as stated in this text is current as at December 2011.

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Really useful websites

Court decisions	
Southern African Legal Information Institute SAFLII publishes a searchable database of every High Court and superior court decision issued in South Africa since 1993. You can download free copies of all these decisions.	www.saflii.org.za/content/south-africa-index
Legislation	
SA government online You can download free copies of every Act of Parliament or Bill since 1991. The legislation is not consolidated, which means that it is in its original form and does not include any amendments.	www.info.gov.za and click on 'documents'
Organisations	
General Council of the Bar of South Africa Find out more about the role of advocates, as well as download a free copy of *Advocate*, the official journal.	www.sabar.co.za
Law Society of South Africa Find out more about the role of attorneys, as well as download a free copy of *De Rebus*, the official journal.	www.lssa.org.za

PART A: THE SOUTH AFRICAN LEGAL SYSTEM

What is law and how does it work?

CHAPTER 1 The concept of law – *The difference between legal rules and moral rules*

CHAPTER 2 Sources of law and the origins of our legal system – *The Roman, Roman-Dutch and British influences on South African law*

CHAPTER 3 Court structures and jurisdiction – *Deciding which court should decide my court case*

CHAPTER 4 Officers of the court and the law, and the development of law – *The role of judges and lawyers*

CHAPTER 5 Litigation, arbitration and mediation – *Different ways for me to resolve legal problems*

Chapter 1

The concept of law

'At his best, man is the noblest of all animals; separated from law and justice he is the worst.'

ARISTOTLE (384 BC–322 BC)
GREEK PHILOSOPHER

What is covered in this chapter

1 What is law?
2 Legal subjects and rights
3 The concept of legal personality
4 Purposes of law
5 Main divisions of law

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

It is important to understand the difference between legal rules and other rules which operate in our society. Just because a person believes something to be morally right does not mean that it is legal. Similarly, just because something is legal does not mean that everyone may believe it to be morally right. Law provides order in our society, but order without justice is meaningless. If a society has laws without justice then it will not be a pleasant place in which to live.

This chapter sets out what law is, why we have law and how the law is categorised to provide order in our world. Importantly, it also introduces you to the concept of legal personality. We all accept that human beings can have rights and duties, but law also creates entities like companies that can also have legal rights and duties.

1 What is law?

The things that people do are subject to two broad groups of rules, or laws:

- **Scientific laws**: These are statements about what people observe repeatedly in nature. They describe what we are able to perceive in the physical universe. We talk about a ‘new’ scientific discovery even though what has been ‘discovered’ has always existed in our world – it is only ‘new’ because we understand it for the first time. Even though we can apply scientific laws to understand our surroundings better, we cannot break these laws because they exist independently of our faith or our hopes. Gravity will exist even if we do not want it to! Examples of scientific laws include the laws of physics, chemistry, economics, and even psychology.
- **Practical laws**: These are rules of conduct. Practical laws set out courses of action for rational human beings. They tell us how thinking people should behave in particular situations. They set out the standards to which human beings ought to aspire. However, people do not always behave the way they should, and practical laws are often broken. Examples of practical laws include rules of law, ethics, honour, and even sport rules, such as the rules for playing cricket and soccer.

Legal law is defined as the body of rules governing human conduct, recognised as binding by people and enforced by the State. It is the authority of the State, and the ability of the State to impose the law by force, that makes a legal system a more influential social control of conduct in society than religion, morality, or ethics.[1]

Law is influenced by natural, social, and moral codes of conduct. Codes are naturally thought to be accepted by people to help them in their understanding of the difference between right and wrong. Codes function through the consciences of individuals, who are free to accept these codes or reject them. They guide human conduct. An example of a moral code is the 15th-century proverb, ‘Do unto others as you would they should do unto you.’

There are differences between law and natural, social, and moral codes.[2] These are shown in Table 1.1.

Table 1.1 *Law and natural, social, and moral codes*

	Law	**Natural, social, and moral codes**
Where does it come from?	Made by a formal process and enforced by the State.	Naturally inherent in people and originate from the community. Accepted by the public on an informal basis.
Compulsory or voluntary	Must be obeyed by all.	Individuals are free to accept or reject.
Purpose	To facilitate order and justice.	To uplift all humankind and to advance civilization.
Formalities	Controls human conduct by formal rules and procedures, and processes such as courts.	Guides human conduct by setting standards, and functions through the consciences of individuals.

The role played by ethics in business decisions is also covered in the web-based text in a separate chapter on business ethics.

2 Legal subjects and rights

A ‘legal subject’ is any person, or entity, who can hold rights and duties in terms of the law. If one legal subject has a right to something, then another legal subject has a duty not to interfere with that right.

A ‘right’ refers to your ability to claim or protect something in which you have a legal interest from another person. If you hold this interest you may legally require another person to give something, or to do something, or to not do something.

Legal subjects may have legal rights to:

- ‘Corporeal’ things, which are physical things that can be touched. For example, ‘immovables’ such as land (which cannot physically be moved from one place to another and still keep the same appearance), or ‘movables’ such as a motor vehicle (which can be moved physically to another place and keep the same appearance).
- ‘Incorporeal’ things, which exist as concepts that are represented by physical things. For example, shares in a company are represented by a share certificate.
- Intellectual property, which are creations of the mind. For example, patents, copyright and trademarks.

There are two types of legal rights: real rights and personal rights.[3] These are illustrated in Table 1.2.

Table 1.2 *Real rights and personal rights*

	Real right	**Personal right**
What is it?	A real right is a right that you hold in a thing, e.g. you own a car. You can protect a real right against anyone in the whole world who tries to interfere or cause you loss, e.g. anyone at all who steals your car or damages it.	A personal right is a right you hold against a specific person, e.g. someone who owes you a debt. You can protect a personal right against that legal subject only, e.g. you can only take legal action for the money against the specific person who owes the debt to you.
How they are created	The most important real rights are those of ownership and possession. Real rights are generally created by agreement (i.e. contract).	Personal rights may be created by agreement (i.e. contract); one person getting an unfair benefit at the expense of someone else (i.e. unjustified enrichment), or by a wrong done by one person to another that causes injury to their body or damage to their property (i.e. delict).
Method of transfer	Real rights may be transferred from a person to another person by delivery in the case of a movable (e.g. a motor vehicle), or by registration in the case of an immovable (e.g. land).	Personal rights may be contractually transferred from one person to another by means of an agreement called ‘cession’.

The State, as enforcer of the law, provides a remedy if the rights of a legal subject have been infringed.

A ‘duty’ is a requirement to do something or not to do something. We can therefore say that a duty is an ‘obligation’.

3 The concept of legal personality

‘Legal personality’ refers to entities which may hold rights and duties in terms of the law. The law defines who or what may have legal personality and the extent of that personality once it is obtained. The law can define, alter, or withdraw legal personality. For example, according to our law, children have fewer rights than adults.

Not all living creatures are legal subjects capable of bearing rights and duties. For example, animals have no rights or duties. However, some non-living creatures may be legal subjects. For example, companies.

Two types of legal subjects exist in South African law:

- **Natural persons**: All human beings have the capacity to bear rights and duties from the time they are born alive. The legal personality of a human being ends automatically on death.
- **Juristic persons**: These are non-living associations which are given the capacity for rights and duties by the law, for example corporations. They only obtain legal personality once they are registered formally. On deregistration a juristic person loses its legal personality.

4 Purposes of law

There are two purposes of law: order and justice.

4.1 Order

The main purpose of the law is to maintain order and peace in the community.[4]

The law limits what people may do. By placing rules on people, the law makes it possible for people to live together peacefully, even if they have competing interests. For example, all motorists must drive on the left-hand side of the road in South Africa. This rule maintains order on our roads.

These rules are both the price and the reward for people living in communities. The same rules that prevent us from abusing others protect us from the abuse of others. Cicero, a Roman statesperson who died in 43 BC, wrote, ‘We are the slaves of the law in order that we may be free.’

4.2 Justice

The concept of ‘justice’ refers to the general sense of people as to what is fair and right. The closer a legal system comes to being just, the more willingly it will be obeyed by people. The law must be seen to be just and fair. An unjust system of law can only be enforced by strong punishment, and the people ultimately will rebel against that.

The law must meet five requirements for it to be considered just. These requirements are called ‘the postulates of justice’:

- **Reasonableness**: Legal rules must be reasonable to achieve justice. Random, senseless, or silly rules bring the legal system into disrepute.
- **Generality**: Legal rules must apply equally and consistently to all legal subjects.
- **Equality**: Legal rules must apply equally in similar circumstances. However, this does not mean absolute equality for everyone. For example, it would not be rational to treat adults in the same way as minors, or the insane in the same way as sane people. But different rules

must not be random, unpredictable, or unreasonable. For example, racial discrimination does not treat people equally in similar circumstances.

- **Certainty**: The same result must be achieved if the circumstances are similar. The law should generally be predictable so that people can anticipate the legal consequences of their conduct.
- **Due process**: An independent, unbiased judiciary must apply the law. Judges must apply justice after giving serious thought to the facts and the law, and their decisions must be made in the interests of the law and of justice, and not to favour one side or the other. Courts should be open to the public, and the loser of a court case should be allowed to take a decision on appeal or review. Courts must be impartial and judges should not be influenced by outsiders, such as a political group or the government. A judge should not hear a matter in which he or she has a personal interest.

S v Basson[5]

The court examined whether a case should be re-heard after the prosecution alleged that the judge was biased. The judge refused to withdraw from hearing the case. The judge later acquitted the accused of 67 counts including murder, fraud, certain drug offences and conspiracy to commit various crimes.

The court held that it was not necessary for a litigant who complained of bias to establish that there was actual bias; a real concern that there could be bias was sufficient. However, there was a presumption against the partiality of a judicial officer. This means that an applicant who alleged real bias or reasonable apprehension of bias had to establish it with convincing evidence. A litigant who complained of bias would not succeed in forcing the judge to withdraw just because the judge ruled against them or had been impatient with the way they conducted their case. Even inappropriate behaviour by a judge would only give rise to an apprehension of bias where the behaviour made it clear that it had arisen not from irritation or impatience but from what might reasonably be perceived as bias.

The legal profession must be competent and independent; able to represent unpopular causes without fearing the consequences.

Affected people must be given prior notice of their rights to participate in future proceedings, and testimony must be open to questioning. Procedures must exist to ensure that all legal subjects are able to receive independent legal advice and representation, access to the courts and to a fair trial before an impartial judge, and protection from State punishment except by the judgment of a competent court. Torture and forced confessions must not be ‘admissible’ as evidence.

Since justice not only must be done but also should be seen to be done, a party to a case must be given an opportunity of presenting his or her version. The principle that both sides to a dispute must be heard is called ‘to hear the other side’ or *audi alteram partem*.

It is important that the courts deal with cases as soon as possible. This is where we get the saying, ‘Justice delayed is justice denied.’

5 Main divisions of law

Broadly, law can be divided into various categories.[6] These are illustrated in Figure 1.1.

5.1 Public international law

This is sometimes called the law of nations, and consists of the body of rules governing the relations between states in times of both peace and war. The basic principles are the recognition of the sovereignty of states and the obligation to respect agreements between sovereign states, which is also known as *pacta sunt servanda.*

This branch of law includes the law of war and neutrality, such as the rules for prisoners of war, and the prohibition of certain weapons, such as land mines and poison gas. It also deals with the law concerning the sea.

The United Nations and the International Court of Justice conduct prosecutions for the violation of international law. In South Africa, an international convention or agreement does not change our law unless it is ratified or confirmed by Parliament. This means that even if the State President signs an international agreement, it will not be binding on the country until it is agreed to by Parliament.

5.2 National law

This means the law of a particular country, and is divided into three main branches:

5.2.1 Procedural law

This set of law regulates how legal rules are applied and enforced. There are three branches of procedural law:[7]

- **Civil procedure**: Deals with the steps to be taken to enforce rights between legal subjects.
- **Criminal procedure**: Sets out the rules of how a criminal court operates, the powers of magistrates and judges in criminal matters, and how persons can be brought before a criminal court.

- **Law of evidence**: Sets out how facts must be proved in a criminal or civil court case.

Figure 1.1 *Main divisions of law*

5.2.2 Conflict of laws

This branch of South African law details the rules for settling an issue before a South African court where the case is so connected to a foreign country that the foreign country's system of law should be considered.

Society of Lloyd's v Price; Society of Lloyd's v Lee[8]

A South African court had to decide whether claims on two contracts had prescribed or not. The law governing the contracts was English law but the case was heard in South Africa.

The respondents argued that the claims had become prescribed in terms of the South African Prescription Act [9] which provided for a three-year period of prescription. The appellant argued that prescription was governed by English law and that in terms of section 24 of the English Limitation Act,[10] the claim had not prescribed.

The court found that under English law prescription was determined by the law of the location of the court where the remedy was being sought; in this case South African law. This resulted in a gap where neither South African nor English law applied. The appropriate way of dealing with such a gap was to adopt an approach that took into account policy considerations of the legal system that had the closest and most real connection with the legal dispute before the court.

The court held that contract was in each case governed by English law and that the claims had not prescribed.

Creutzburg and another v Commercial Bank of Namibia Ltd [11]

Residents in South Africa signed a deed of suretyship in Namibia. The contract stated that it would be governed by South African and/or Namibian law, as the case might be.

The court held that where parties make an express choice of law to govern a contract, that choice should be upheld. However, in the absence of a specific choice, the general principle was that the law of the place where the contract was entered into determined the formalities of a contract. In this case it was Namibian law.

5.2.3 Substantive law

These rules define what is acceptable conduct in society, and deal with the creation, operation, and termination of rights and obligations between legal subjects, or between the State and legal subjects. It is divided into public law and private law.

5.2.3.1 Public law

This is the law governing the relationship between the State and the individual, and the way that the State functions and is organised. It is divided into five main categories:[12]

- **Constitutional law**: This branch of law deals with the composition, authority, and functions of governmental bodies, such as the structure and functions of the State, provinces, State President, executive, legislature, and judiciary.
- **Administrative law**: This branch of law deals with the structure and functions of local authorities, and public corporations such as Eskom and the South African Broadcasting Corporation (SABC). Administrative decisions that materially and adversely affect the rights or legitimate expectations of any person must be lawful, reasonable and procedurally fair.
- **Criminal law**: This branch of law defines what constitutes a crime and prescribes the penalties for criminal conduct.
- **Labour law**: This is the law that deals with the relationship between employers and employees.
- **Law of taxation**: The collection of revenue by the State is dealt with by this branch of law.

5.2.3.2 Private law

There are five main divisions in this branch of law:[13]

- **Law of persons (including family law**): This branch of law deals with the legal status of natural persons, such as minors and insane persons, and involves factors influencing capacity, such as age. Family law deals with the law of domestic relations and the legal rules for family relationships, such as marriage, divorce, domestic partnership, children and guardianship.
- **Law of property**: This branch of law is concerned with real rights such as ownership and possession, servitudes, mortgages and hypothecs, pledges, and liens.
- **Mercantile law**: There is no simple categorisation of laws that fall under the heading of mercantile law. However, mercantile law is a collection of branches of law that are important in trade and commerce. It includes company law, negotiable instruments, insolvency, insurance, maritime law, and banking law.
- **Law of succession**: This deals with what happens to a person’s estate on death. In testamentary succession, the deceased leaves a valid will. In

intestate succession, there is no will at all, or the whole or part of the estate of the deceased was not disposed of by a valid will.

- **Law of obligations**: This branch of law deals with personal rights, and is divided into three categories:
  - **Law of contract**: A contract is usually defined as a binding agreement between two or more persons by which one or both of them promises to give something, or do something, or not do something. It is therefore an agreement intended to create or end personal rights between the parties.
  - **Law of delict**: A delict is an intentional or negligent wrongful act that causes damage to property or injury to a person. This branch of law is known in England and in the United States of America as the law of tort.
  - **Law of unjustifiable enrichment**: This concerns obtaining recovery or compensation for a benefit that was received without a valid cause.

PRACTICALLY SPEAKING

How an attorney can help when starting a business[14]

For some small business owners, using an attorney is like calling a fireman or a plumber: you only do it if there is a problem and it is hurting.

Especially for new businesses, marketing, sales, staffing and just getting the business off the ground can take priority over legal issues, particularly ones that do not seem to be urgent. But clever business planning also includes preventing problems and making sure that the business is protected against potential trouble in future.

- **Corporate governance**: While most corporations will use an attorney to help with the process of incorporation, new businesses sometimes forget the ongoing legal requirements to maintain their corporation status. Annual shareholder, director and partner meetings must be held, and recording of minutes and election of officers must comply with the law. Failure to do so could result in piercing of the corporate veil in the event of legal action, and this could expose corporate officers to personal liability or other legal problems.
- **Intellectual property**: Many intangible assets of a business should be protected legally. A company's name, logo, brand name and distinctive goods and services are entitled to copyright protection. Proprietary computer software, semiconductor chip mask designs, vessel hull designs and many other creations may be eligible for trademark registration.

  Patents are often thought to cover only machines and other manufactured products, but can also protect processes, such as a method for refining petrol, or new

compositions of matter, such as chemical compounds or mixtures. Trademark, copyright and patent registrations can help a business protect the things that give it a competitive advantage.

- **Employment agreements**: Many companies regard the skills and knowledge of their employees as their most important assets, but fail to protect those assets through non-disclosure and restraint of trade agreements with their employees. Inevitably, some employees will leave the company. It is important to protect your business against their taking their knowledge of customer lists and trade secrets with them over to your competitors.
- **Exit strategies**: Entrepreneurs sometimes are so highly focused on starting a new business that they do not consider what would happen if one of the principals was to leave the business. When a partner or major shareholder decides to exit suddenly, it can potentially threaten the ability of the business to continue operating. Closely-held corporations need to have buy-sell agreements or buy-back agreements to ensure that partners or major shareholders can sell their interests without legal complexity or placing an undue financial burden on the company.

Good attorneys are not cheap, but neither is any other consultant critical to your business. A brief consultation with an attorney can help determine what the legal needs are of the business. An investment of an attorney’s time can also help prevent major problems in future.

THIS CHAPTER IN ESSENCE

1. Legal law is defined as the body of rules governing human conduct, recognised as binding by people and enforced by the State.
2. Law is influenced by natural, social, and moral codes of conduct.
3. A legal subject is any person, or entity, who can hold rights and duties in terms of the law. Real rights can exist over a thing, whereas personal rights are held against individuals.
4. A natural person is a human being; a juristic person is an entity which the law regards as having a legal personality.
5. For a law to be just, it must be reasonable, apply generally and equally, result in certainty and be applied through due process.

QUESTIONS

Short questions (1–5 marks)

1. List two purposes of law.
2. List the five postulates of justice.
3. List five categories of Public law.
4. List the five main divisions of Private law.

Paragraph questions (5 marks)

1. What are the differences between scientific laws and practical laws?
2. Define what law means.
3. Draw a table to distinguish between law, and a moral code.
4. Distinguish between a real right and a personal right.
5. Distinguish between natural and juristic persons.

Essay question (10 marks)

1. Draw a diagram to illustrate the various divisions and branches of law.

1 Fouché, 3–4; Hahlo and Kahn, 3–6; Havenga et al., 23–24; Swanepoel et al., 2.

2 Swanepoel et al., 2.

3 Sharrock, 2–3.

4 Hahlo and Kahn, 25–63.

5 *S v Basson* 2007 (3) SA 582 (CC).

6 Fouché, 11–13; Hahlo and Kahn, 108–128; Sharrock, 34–36; Swanepoel et al., 5–8.

7 Sharrock, 38–39.

8 *Society of Lloyd's v Price*; *Society of Lloyd's v Lee* 2006 (5) SA 393 (SCA).

9 Prescription Act 68 of 1969.

10 Limitation Act of 1980.

11 *Creutzburg and another v Commercial Bank of Namibia Ltd* [2006] 4 All SA 327 (SCA).

12 Sharrock, 37.

13 Sharrock, 37–38.

14 Source: http://smallbusiness.findlaw.com/starting-business/starting-business-overview, accessed 3 January 2012. Copyright © 2011 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 2

Sources of law and the origins of our legal system

'There is an orderliness in the universe, there is an unalterable law governing everything and every being that exists or lives. It is no blind law; for no blind law can govern the conduct of living beings.'

MOHANDAS GANDHI (1869–1948)
INDIAN LEADER AND ADVOCATE OF NON-VIOLENCE

What is covered in this chapter

1 Sources of law
2 Legislation
3 The development of the common law
4 Judicial precedent
5 Judicial interpretation of statute
6 Commentaries
7 Customs
8 Customary law
9 Foreign law
10 Citation of court cases
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Our history colours and influences the way we live today. By understanding the historical background of our law we give respect to the people who have over many centuries tried to improve things in our society. The failures and successes of laws that applied for thousands of years help to explain the procedures we have adopted to make new laws, and the protections we have designed in our Constitution to protect our citizens.

Sometimes our courts are faced with a situation where Parliament has simply not passed any Act about a particular issue; sometimes the only guidance a court may get is from previous court decisions, ancient writings, old customs, or other countries. This means that the history of our past can affect decisions made by courts today. For example, Parliament has never passed a law prohibiting murder, rape or theft, and yet people are charged, convicted and sentenced to jail for many years for these crimes. The authority our courts have to deal with these matters comes to us from our rich history and our common law.

1 Sources of law[1]

All law applicable in South Africa originates from the following sources:

- **Legislation**: This includes the Constitution.[2]
- **Common law**: This consists of all the laws considered by South African courts as being persuasive or binding. It is all the law except for legislation, and includes all the following:
  - Judicial precedent.
  - Judicial interpretation of statute.
  - Commentaries.
  - Customs.
  - Customary law.
  - Foreign law.

2 Legislation[3]

Legislation is defined as the setting down of binding rules of law in a formalised way, by an authority that has the legal capacity to do so. The authority of Parliament is ‘sovereign’ which means that it may pass any law, subject to the Constitution.[4] The laws passed by Parliament are known as ‘original legislation.’

Parliament may also pass laws allowing other bodies like provincial governments, local authorities, and city councils to make certain laws for certain purposes. The powers of these other bodies only exist because they are granted by an Act of Parliament, and their authority is therefore ‘delegated.’ The laws passed by these bodies are known as ‘subordinate legislation’ which may take the form of regulations, provincial ordinances, or municipal or city council by-laws.

If there is any conflict between an Act of Parliament and any subordinate legislation, the Act will prevail. Where the subordinate legislation goes beyond the authority it is given by the Act of Parliament, we say that it is ‘outside the powers of the law’ and is *ultra vires.*

Generally, legislation and regulations, ordinances and by-laws will continue to apply until they are amended or revoked by Parliament, or struck down by a court. A court can strike down a whole law or just a part of it. Sometimes, though very rarely, a law becomes so out of date that it becomes useless. This is known as ‘abrogation through disuse.’ The common-law offence of adultery is an example of a law that has been abrogated by disuse.[5]

2.1 The Constitution[6]

This is the supreme law in the Republic of South Africa, and prevails over all other laws.

The Constitution comprises 14 chapters. It deals with, amongst other things, the structure of Parliament, the President and national executive, provinces, local government, courts and the administration of justice, public

administration, traditional leaders, and finance. General provisions deal with issues like the national flag and election procedures.

The Bill of Rights is contained in chapter 2 of the Constitution. It guarantees the freedom, equality, and dignity of all citizens. The Bill of Rights applies to all relations between the State and citizens, but does not necessarily apply in matters between citizens themselves. Any court, when interpreting any law or in applying the common law, must consider the spirit and objectives of the Bill of Rights.

The Constitution provides for the separation of the legislative, executive and judicial arms of government. The nine provinces (Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Mpumalanga, Northern Cape, Limpopo, North West and the Western Cape) may pass laws on certain matters such as education, health and housing. However, Parliament has supreme power in these areas, and may pass any laws that override provincial legislation. The provinces may pass exclusive laws on less important matters such as abattoirs and liquor licences. The provinces have a role in drafting national legislation through their participation in the National Council of Provinces, the second house of Parliament.[7]

2.2 How a Bill becomes an Act of Parliament

There are two houses in the national parliament. This means that Parliament is ‘bicameral’ and consists of:

- **The National Assembly**: Members are elected for a five-year term according to a system of proportional representation. There are between 350 and 400 members.
- **The National Council of Provinces**: There are ten representatives from each province, which each vote as a block.[8]

The President is the Head of State and governs with a cabinet, comprising Ministers and Deputy Ministers who head the various national government departments. The President, Deputy President and the cabinet are collectively called the ‘executive’.

The National Assembly’s Parliamentary Portfolio Committees, and the National Council of Provinces’ Select Committees, oversee the work of the executive and discuss proposed Bills in areas of their portfolios.

Legislation begins as a Bill. Bills come from government departments, and may result from previous consultation through the publishing of green papers (discussion documents) and white papers (cabinet approved policy documents). Draft Bills may be published for comment in a newspaper issued by the State called the *Government Gazette.* Bills may be amended many times as a result of discussion in a portfolio committee or select committee.

When a Bill has been passed by both houses of Parliament it goes to the State President for agreement and signature. Then it is published in the *Government Gazette* as an Act of Parliament. Each Act is given a date and number. For example, the Promotion of National Unity and Reconciliation Act is Act 34 of 1995. This means it was the 34th Act to be passed by Parliament in 1995.

Sometimes, a commencement date is proclaimed separately by the President, by a notice published in the *Government Gazette.* Specific regulations in terms of the various Acts are drawn up by the ministries concerned, and also published in the *Government Gazette*.[9]

The passage of a Bill through the Houses of Parliament is discussed in more detail in the web-based text in chapter 39 on the Constitution.

3 The development of the common law

Common law may be defined as the whole of the law of a country that does not originate from the legislation of that country. Typically its foundation is the body of law inherited from a particular former legal system.[10]

Common law, however, evolves over time and can change, and is built upon by decided case law handed down by judges from time to time.

The history of South African law consists of the history of Roman-Dutch law in Europe, and its transportation to South Africa. Roman-Dutch law refers to the legal system that applied in the Netherlands during the 17th and 18th centuries. It consisted of both medieval Dutch law (mainly of Germanic origin) and Roman law. This legal system owes its name to Simon van Leeuwen who used it in 1664 as the title of his most important work called *Het Roomsch-Hollandsch Recht.*

The development of South African common law can be traced back to ancient times.[11]

3.1 The Roman law

Early Roman law was a mixture of custom and interpretation by magistrates of the will of the gods. These magistrates later lost their legitimacy because of unfairly discriminating against the lower class known as ‘plebeians’. The threat of revolution by the lower class led in 450 BC to the promulgation of the ‘Twelve Tables of Rome’.

These were bronze tablets setting out existing custom concerning property, payment of debts, and appropriate compensation or other remedies for damage to persons. The Twelve Tables of Rome are the historical basis for the modern view that fairness requires law to be in written form.[12]

The Twelve Tables promoted the organisation of public prosecution of crimes and instituted a system whereby injured parties could seek compensation from their aggressors. More importantly, they protected the lower class from the legal abuses of the ruling class known as ‘patricians’, especially in the enforcement of debts. From that point on, a basic principle of Roman law was that the law must be written and justice could not be left in the hands of judges alone to interpret. It also prohibited inter-class

marriages, seriously punished theft and gave fathers rights of life or death over their sons. The Twelve Tables also punished the misuse of magic.

Written on wood and bronze tablets, the Twelve Tables survived almost 1 000 years until destroyed by invaders from Gaul (France) in AD 390.

Roman law consisted of two systems:

- **Law of Citizens**: This system of law was also known as the *ius civile.* It applied only to citizens of the city-state of Rome and was extremely formalistic and rigid.
- **Law of Nations**: Also known as the *ius gentium.* This legal system applied to non-citizens of the city-state of Rome, and people in all the conquered territories of the Roman Empire. It stressed principles such as the upholding of good faith, prohibition of unjustified enrichment, and doing away with unnecessary procedural requirements. Because the Empire was so vast, lawmakers adopted many local practices and principles. This resulted in the Law of Nations becoming more moderate and flexible than the Law of Citizens that applied to Roman citizens.

The principles of Roman law were amended to suit conditions in the conquered territories. The various local systems of law in these territories, as amended by the Law of Nations, were translated into many different local languages.

3.2 The Germanic influence (100 BC–AD 600)

The territory west of the Rhine River in Europe was occupied by Germanic tribes, each living according to its own tribal legal system established by custom. During the first century BC, these lands were conquered by the Roman emperor, Julius Caesar. Roman law was introduced by Roman settlers when they occupied this area.

3.3 The Justinian Code

By the 6th century AD, the Roman Empire was in a state of decay and virtually in collapse. Justinian (Flavius Petrus Sabgatius Justinianus), a Roman emperor of the time, adopted a policy of restoration of the Roman Empire. As this required a uniform legal system, Justinian set about to reduce the number of laws. He appointed a well-known jurist called

Trebonianus to head a commission to collect and consolidate existing Roman law. The results of their ten-year project became the ‘Code of Civil Law’ or *Corpus Juris Civilis*, also called the ‘Justinian Code’ which comprised four parts.

The first three parts of the Justinian Code were issued in Latin, in AD 534:[13]

- The ‘Codex’ or *Codex Justinianus* compiled all the imperial laws from the time of Hadrian. It used both the *Codex Theodosianus* and private collections such as the *Codex Gregorianus* and *Codex Hermogenianus*.
- The ‘Digest’ or *Pandects* compiled the writings of the great Roman jurists such as Ulpian along with edicts current at the time. It constituted both the current law of the time, and was a turning point in Roman law. From that time onwards, the sometimes contradictory case law of the past was absorbed into an ordered legal system.
- The ‘Institutes’ was intended as a sort of legal textbook for law schools and included extracts from the two major works.

Later, Justinian issued a number of other laws, mostly in Greek, which were called ‘Novels’.

These four components of the Justinian Code, collectively referred to as the Code of Civil Law, served as an important basis for law in contemporary society inspired by logic-based Greek legal principles. Many legal maxims still in use today are derived from the Justinian Code. His work inspired the modern concept and spelling of the word ‘justice’.

The Justinian Code formed the basis of the laws of the countries of western Europe, excluding England, and traces of it can also be found in the law of Italy, Scotland and Quebec. It is occasionally cited in court cases in South Africa today.

3.4 The Frankish Empire (600–800)

The Frankish tribes (related to the Germanic tribes) had kingdoms that included most of western and central Europe. They established kingdoms in the territories previously ruled by emperors called *caesars* from Rome.

Each tribe had its own legal system that applied only to people belonging to that particular tribe. Roman settlers were governed by Roman

law. As the influence of Rome spread, so too did the influence of Roman Law.

3.5 The Middle Ages (900–1400)

The Frankish Empire was divided into three parts in terms of the Treaty of Verdun of AD 843. As feudalism spread, people were governed by the principle of territoriality. This means that a person is ruled by the law of the place where he or she is physically situated, and not by the law of his or her tribe. To make things more complicated, the laws of different feudal systems differed from one another.

As towns grew and commerce developed, so too did the need for a more uniform legal system. Roman law was used to supplement local laws to such an extent that over time it replaced local laws. By the 15th century, Roman law had become the generally accepted legal system applied in Germany and the Netherlands.

3.6 The Dutch Republic (1581–1795)

The legal system applicable in the Netherlands was called Roman-Dutch law. The Netherlands at this time was a great colonial power, with outposts around the world, from New Amsterdam (New York in the United States) to Batavia in the East Indies (Jakarta in Indonesia).

Dutch trading companies carried the legal system of the Netherlands with them to these outposts, including the Dutch shipping station at the Cape of Good Hope, where in 1652 Jan Van Riebeeck introduced the Roman-Dutch law of the Netherlands. Despite many setbacks, the settlement survived. For the next 143 years the law of the Netherlands was applied to the Cape, subject to minor variations.

3.7 The British era (1795–1910)

Roman-Dutch law was applied at the Cape during the First British Occupation (1795–1803) and the subsequent administration of the Batavian (Dutch) Republic (1803–1806).

After Britain occupied the Cape for the second time, Roman-Dutch law continued to apply. This was due largely to a rule of British law that stated

that the laws of a conquered country continue in force until they are altered by the conquerors. The validity of applying Roman-Dutch law in the Cape was confirmed by Britain when it passed the first and second Charters of Justice of 1827 and 1834 respectively.

During the period of British occupation, however, English law influenced Roman-Dutch law considerably by means of various enactments and court judgments, and the adoption of English procedural law. Where gaps existed in the law, English law was applied.

Furthermore, Roman-Dutch law did not always cater for the requirements of the modern society that developed during the 19th century. Laws were passed that were often based on English legislation and interpreted using relevant English court cases. The advocates and judges of the superior courts were usually trained in England. As a result the Roman-Dutch law of the Cape Colony was overlaid with a heavy English law influence.[14]

English law was very influential in the development of our law of negotiable instruments, insurance law, company law, and law of evidence. To this day, the influence of English law is still evident in our criminal law and our laws of agency, delict, and contract.

The Cape Supreme Court was established in Cape Town in 1828. When it became necessary for mobile courts to travel around the Cape Colony as the population increased, divisions of the Court were established in the Eastern Cape and in the Northern Cape (then known as Griqualand West).

In 1844, Natal was annexed by Britain and became a Crown Colony. The *Voortrekkers* moved further north east, and established the Orange Free State and the South African Republic to the north of the Vaal River. The Orange Free State instituted a High Court in 1854,[15] the Natal Supreme Court was established in 1857, and the first High Court of Justice was set up in the South African Republic in 1877.

3.8 The Union of South Africa (1910)

In 1910, a political compromise was reached when the Cape and Natal colonies, and the Transvaal and Orange Free State former republics, combined to form four provinces in a national union. Each province’s capital was allocated a different function of national government. Each

province would continue to apply its own common law, but laws passed by the Union Parliament would apply to all provinces. To this day there are differences in our common law based on the former provincial boundaries.

Following the Union of South Africa in 1910, a new Supreme Court of South Africa was formed, with provincial and local divisions in all four provinces. A new Appellate Division in Bloemfontein heard appeals from the other divisions of the Supreme Court and set precedents that were binding countrywide.

3.9 Apartheid South Africa

After the National Party victory in 1948, the Afrikaans-speaking National Party followed a fiercely anti-British policy based on their experience during the Boer War. After appointing judges who were also anti-British, the English Privy Council was abolished as the highest court of appeal in the South African judicial system.[16]

Apartheid laws aimed at separating whites and blacks. This was done by enforcing the theory that whites should be treated more favourably than blacks, that separate facilities need not be equal, and by providing the State with the powers deemed necessary to deal with any opposition.

Other laws provided for geographic, social, and political separation. Police powers also expanded. The concept of unequal allocation of resources was built into legislation on general facilities, education, and jobs.

After South Africa became a republic in 1961, the government implemented several steps to make the theory of apartheid work in practice. The policy was designed to result in all black persons being citizens of independent homelands, vote for governments in these homelands and lose their South African citizenship. Infrastructure was built within the independent states to create the basis for a legal system, including superior and inferior courts, all modelled on South African law and legal principles.

3.10 Dismantling apartheid

The National Peace Accord of September 1991 established five working groups to take the lead in creating a climate for free political activity; in determining basic constitutional principles; in establishing transitional procedures for the nominally independent homelands of Bophuthatswana,

Ciskei, Transkei, and Venda; in setting and overseeing timetables for the transition; and in dealing with new problems that would arise during the transition itself.

The draft constitution published in July 1993 contained a federal system of regional legislatures, equal voting rights regardless of race, and a bicameral legislature. In November 1993, negotiators endorsed the draft of the interim constitution calling for a five-year transitional government.[17]

One of the most important items of business for the new Parliament was to approve a final constitution for South Africa.

3.11 Democratic South Africa (1996 to current date)

In terms of the Constitution,[18] the existing provincial and local divisions of the former supreme court (including the courts in the independent homelands) were renamed High Courts, and the Appellate Division was re-established as the Supreme Court of Appeal. A new superior court, the Constitutional Court, was established to decide matters based on Constitutional provisions. Other superior courts, created in terms of separate legislation, include the Land Claims Court and the Labour Appeal Court.[19]

4 Judicial precedent

‘Judicial precedent’ is the body of law resulting from decisions on points of law made by other courts with regard to the same circumstances.[20]

Judges do not make new law, but interpret and apply existing laws. Sometimes, however, existing law is unclear or confusing, or can lead to two or more possible solutions to a problem. In making a decision, the court can extend an existing rule of law or sometimes apply a completely new principle. The modification of the law can then become binding due to what is called ‘precedent’.

The concept of precedent means that there is a natural tendency to regard past decisions as a guide to future actions. To promote certainty and equality of the law, there is a general duty for judges and magistrates to follow legal rulings in previous cases. Litigants would feel unjustly treated if a past ruling were not followed in a case where the material facts were the same.

The authority given to past decisions of courts is called the ‘doctrine of precedent’. This comes to us from the Latin expression *stare decisis et non quieta movere* which means to ‘stand by decisions and do not disturb the undisturbed’.

There are several advantages of the doctrine of precedent:

- Once people know what the law is and the consequences of certain conduct, it enables legal subjects to plan their private and professional lives.
- People will not be unaware of the rules of law.
- It decreases litigation.
- It provides guidance to judges and magistrates and reduces the possibility of partial or prejudicial decisions. This promotes public confidence in the judicial system.
- It saves time and reduces the costs of litigation.
- It promotes certainty in the law, as well as predictability, reliability, equality, uniformity, and convenience.[21]

There are also several problems associated with a strict application of the doctrine of precedent:

- Incorrect decisions may become precedents and be applied in future cases.
- Too strict an application prevents the law from changing in accordance with the changing values of society.
- In seeking to avoid its application, petty distinctions may be made to try to distinguish cases from one another.

Depending on the seniority of the court handing down the decision in a particular province, other courts will be bound to follow that decision on that particular point of law. As a general rule, each court is bound by decisions of a superior court within that same province. This means that magistrates' courts in a province must follow decisions of the High Court in that province, which in turn must follow decisions of the Supreme Court of Appeal, which take precedence over conflicting High Court decisions in all provinces. Decisions of the Constitutional Court are binding on all other courts.

Different divisions of the High Court do not have to follow previous decisions of one another, because they are in different provinces. However, decisions of other divisions of the High Court in other provinces do have great persuasive effect. If there are conflicting precedents from two High Courts in different provinces, then the court with the most judges supporting a decision will have greater authority.

Different decisions of magistrates' courts have no binding precedent value.

In situations where there is doubt about the original common law, or about the meaning to be assigned to a statute, a judgment of the High Court defines the law. Decisions of South African courts have had to adapt much of the original basic Roman-Dutch principles to deal effectively with the realities of a modern South African society.

Cases decided in other countries have little or no persuasive value, except in certain cases where the law in that country is very similar to South African law.

It is only the 'legal principle' of each case or *ratio decidendi* that applies to future cases and will be binding. Only a pronouncement on law

can constitute the legal principle. The value of decided cases is therefore not found in the facts of those cases, but in the principles of law that are laid down. Any other comments, remarks, or findings made by judges are, at most, only of persuasive value in reaching a decision. These are known as ‘remarks made in passing’ or *obiter dicta*.[22]

To determine the law, lawyers first see whether there is any legislation on the problem. If there is not, the lawyer will look to the common law and to precedents laid down by judges.

5 Judicial interpretation of statute

Parliament may pass legislation that is confusing, contradictory, vague, inconsistent with similar legislation, or that makes inroads on the constitutional rights of certain persons.

Courts are sometimes required to establish the intention of Parliament in originally passing the Act and interpret the Act in accordance with this intention. In addition, the Constitution[23] provides that where a court believes that a decision contradicts the Constitution, it must interpret legislation to promote the spirit, purpose and objects of the Constitution.

Where possible, courts will therefore interpret legislation to give effect to changing values in our society and to ensure that justice, fairness, equity, and the freedom of the individual are protected and maintained.[24]

Where the language then becomes clear, the courts must give effect to the interpretation unless to do so would lead to absurdity that could never have been contemplated by Parliament, or where the result would be contrary to what Parliament intended.[25] The words used in a statute must therefore be viewed in the broader context of the legislation as a whole.[26]

Courts will adopt the following approach to interpreting legislation:[27]

- Ordinary words will be given their ordinary grammatical meaning at the time an Act was written.
- Differences between translated versions of an Act will be resolved by referring to the original language version of an Act as signed by the State President.
- Usually, an Act is written in English and translated into another official language. The State President normally alternates between signing the English version and the translated version. Sometimes the translation of an Act may have a different meaning from the version in the language originally signed by the State President. The courts generally will look to the version originally signed by the State President to determine what an Act means.
- Words and expressions used throughout an Act should have the same meaning.

- Words and expressions, which have been interpreted by the courts previously, should bear the same meaning as previously interpreted.
- An Act will not bind the State unless the State is specifically mentioned as being bound.
- Any provisions that seek to restrict the jurisdiction of the superior courts will be very strictly construed.
- An Act should not be given retrospective effect as this would amount to taking away the rights of legal subjects.
- It will be assumed that the law was not intended to be unreasonable, create injustice, or apply only to certain legal subjects.
- Laws will be interpreted as promoting the public interest.
- The purpose of the Act must be considered in interpreting it. No interpretation will be considered which will allow fraud or any evasion of the object of an Act.
- The law must try to give effect to established principles of international law.

6 Commentaries

Since the time of Roman Emperor Justinian, hundreds of commentaries have been written on the Justinian Code by various authors. The original Justinian Code itself has been lost, but the commentaries have remained in existence. These form the origin of our law.

This compilation of Roman law greatly influenced the law of the Netherlands. The first Dutch writer to bring some kind of order to this vast mass of legal principles was Hugo de Groot, known as Grotius, in his law text called *Inleiding tot de Hollandsche Rechtsgeleerheyt* which was published in 1631.

Among the other important Dutch writers of the 17th and 18th centuries were Johannes Voet, Groenewegen, Van Leeuwen, Huber, Van der Keessel, and Van der Linden.

Where the opinions of the old writers clash, the court will choose a point of view most consistent with reasonableness, fairness, usefulness, and justice.[28]

Modern textbooks of academics are not regarded as authoritative sources of law. They are treated as secondary sources of law, that is, valuable guides where the court is faced with circumstances where there is no binding source of law to guide them.

7 Customs

Sometimes the courts will recognise that a community will do things in a particular way. The courts may even enforce these practices or customs. Customs only may have the force of law if they can be shown to be long established, certain, reasonable, and uniformly observed.[29]

Van Breda v Jacobs[30]

One group of fishermen placed their lines in front of another group's fishing lines, and caught the entire shoal of fish. The plaintiffs sued for the value of the fish, claiming that there was a custom among local fishermen not to place lines in such a way.

The court agreed, finding that the custom was reasonable and certain and had been observed for over 45 years.

Closely related to custom is trade usage, that is, a practice in a particular trade that is so well known and consistently followed that it is deemed to be included in every contract made, on the assumption that it expresses the wish of the parties. It is an unspoken or tacit term customarily implied in a contract, unless the parties expressly exclude it.

8 Customary law

Tribal African law may be applied by a court if the parties wish it to be. However, the court may take notice of that law in reaching a decision only if it is possible to determine what that law is, and as long as it does not conflict with public policy.[31]

Bhe and others v Magistrate, Khayelitsha, and others [32]

The court tested the values of customary law against the values enshrined in the Constitution.[33] In this case the court had to decide if the customary law rules of primogeniture would apply to exclude women from sharing in the estate of a person who died without a will (intestate succession).

The general customary law rule is that only a male who is related to the deceased through a male line qualifies as intestate heir. In a monogamous family the elder son of the family head is his heir. If the elder son does not survive his father, then the elder son's eldest male descendant is the heir. If there is no surviving male descendant in the line of the deceased's eldest son, then an heir is sought in the line of the second, third and further sons, in accordance with the 'principle of primogeniture'. If the deceased is not survived by any male descendant, his father becomes his heir. If his father does not survive him, an heir is sought in the father's male descendants related to him through the male line.

In this case the grandfather claimed, under customary law, to be entitled to inherit his deceased son's intestate estate in preference to two minor female descendants of the deceased.

The court disagreed, saying that the customary law of succession, together with sections of the Black Administration Act [34] and the Intestate Succession Act,[35] were unconstitutional and invalid. These laws discriminated against black females by excluding them from inheriting from an intestate estate governed by customary law. The court held that black females, irrespective of age or social status, are entitled to inherit from their parents' intestate estate like any male person.

9 Foreign law

Foreign law has persuasive influence only. The Constitution[36] provides specifically that in interpreting the Bill of Rights, a court must have regard to public international law and may consider decisions of courts in other countries.[37]

10 Citation of court cases

It is important to be able to find out what the law is. This is because South Africa applies a system of judicial precedent. To enable people to research previous court decisions, important court cases are reported in various publications. Possibly the best known publication of important court decisions in South Africa is the series of *South African Law Reports* issued in six volumes each year. For annual fees, publishers produce the reports on CDs or allow subscribers to access the reports on internet sites.

What is meant by the 'citation' of a court case? This simply means the way the name is written, printed or the case is referred to. For example: 'Client v Corporation 2004 (3) SA 497 (SCA)'. The name of a civil case is cited by first writing the names of the parties. The person suing the other party is called the 'plaintiff'. The person being sued is the 'defendant'. Note the underlining that is used when writing out case names. This indicates that the names would be *italicised* if printed or typed.

It is possible for there to be more than one plaintiff or more than one defendant. In a case where, for example, there are two or more plaintiffs, they are referred to as the 'first plaintiff' and the 'second plaintiff' respectively. Similarly, in a case involving two or more defendants, they are referred to as the 'first defendant' and the 'second defendant' respectively.

Next is the year of publication of the judgment. This is followed by the volume number and abbreviation of the publication in which the judgment can be found. For example, '(3) SA' means the third volume of the *South African Law Reports* in which High Court decisions are reported. Next is the page reference at which the judgment starts.

Finally, there is an abbreviation for the court that heard the matter. For example, '(SCA)' means the Supreme Court of Appeal. Each publishing company uses different abbreviations for the names of the courts, so it can be confusing.[38]

Sometimes, instead of citing the name of a case, a passage from a judgment is quoted. The reference would be the same as above, except for the addition at the end of the citation of a page and paragraph number at which the passage may be found. For example, '498B–D' indicates a passage at page 498, from paragraph B to paragraph D. Similarly, '498B–

523G' means a passage starting at page 498 paragraph B and going all the way through to page 523 at paragraph G.

Civil cases may be referred to and written simply as 'Client v Corporation' or sometimes just the name of the plaintiff will be sufficient to be able to identify the relevant case, such as 'Client'.

A criminal case is cited similarly, except that there is no plaintiff or defendant. The State always brings a charge against an accused. Because the State is the party initiating the action the name of the State is always first, represented by the letter 'S'. The name of the State is always followed by the name of the accused. Look at the following example: 'S v Student 2003 (2) SA 114 (SCA)'. In that example, the name of the accused person is 'Student'. Similarly, a criminal case may be referred to by the name of the accused. For example, 'Student'.

When typing or printing a case name, we use italics instead of underlining, for example, *Client v Corporation* or *Client*. See the many examples of citations published in this text to guide you.

When writing examinations, it is not always necessary to provide the entire detailed case citation. However, you are expected to write down the names of the parties. When writing assignments or articles, however, the full detailed citation must always be provided.

Examples of other words and abbreviations commonly used to cite cases:

- *Ex parte Roos* 1955 (1) SA 572 (O) – in this case, the words *Ex parte* mean 'one party only'. This means that an applicant has initiated an application in court that concerns only himself or herself, and not any other person. For example, someone is bringing an application to the High Court to be admitted as an attorney.
- *De Lange v Smuts NNO and others* 1988 (3) SA 785 (CC) – in this case the abbreviation *NNO* means that the person is acting on behalf of someone else or *nomine officio*. For example, the defendant Smuts is represented by a guardian acting on the defendant's behalf.
- *S v A and another* 1971 (2) SA 293 (T) – in this criminal case only the first letter of an accused's surname is used to hide the identity of the accused. Our society believes that in some cases the identities of some people must be protected. For example, this is a criminal matter in which 'A' is a minor.

- *and another* or *and others* indicates that there are two or more plaintiffs, or two or more defendants. For example, in *S v A and another*, there are two defendants in a criminal matter.
- *In re Pennington Health Committee* 1980 (4) SA 243 (N) – in this case the words *In re* mean 'in the matter of'. In other words, it is an application of some sort initiated by the Pennington Health Committee.

PRACTICALLY SPEAKING

Financing a small business: Loans or equity investment[39]

One of the hardest decisions facing a small business owner is how to obtain financing for their business. Most business owners really have two options: take out a loan or sell a piece of their business for startup cash.

Choosing between loans and equity

If you are starting to set up your business, it makes sense to consider selling a portion of your business called an 'equity stake'. This will help you obtain financing to get the business off the ground. Equity sales are advantageous because they do not require repayment. Since most businesses do not make a profit for a significant time period it makes paying back loans extremely difficult in the early days of a new business.

If you have an established business and have ongoing financing needs, then a loan may make more sense. Loans are easier to deal with when a company has enough cash flow to make repayment realistic, and an established company likely has more collateral to offer to secure the loans. Finally, since loans and equity are treated differently for tax purposes, it makes sense to consult with a business tax advisor to see if one course of action makes more sense than the other.

Loans

Whether you should choose loans or not depends largely on the maturity of your business, your cash flow, and whether you are simply unwilling to give up any more control in your company.

The biggest advantage for choosing a loan is that you keep control over your business. Unlike equity investors, lenders have no say in your business and are not entitled to your business profits. The only obligation you owe to your lender is to repay the loan as agreed upon. Also, loan payments that go towards paying off the interest on the loan can be deducted as a business expense for tax purposes.

The biggest disadvantage of loans is that you have to pay back a steady amount on a consistent schedule, and, as anyone who runs a business knows, profits can be very unsteady. You may have to make a large loan payment at the exact time that you need the cash for your business the most. Another disadvantage is that many small business

owners have to use personal property as collateral to secure the loan, which puts them personally at risk if the business goes under.

Equity

Issues that influence your decision to use equity sales to fund your business include whether your business is still young or expanding and your willingness to give control over the business to other people.

Although many may see giving other people an interest in their business as losing control, this does not have to be the case. The right investors can be extremely helpful in terms of running the business, establishing business connections and offering valuable advice and assistance. Another advantage of equity investments over loans is that they tend to be far more creative and flexible, which many businesses may prefer. The single biggest advantage of selling equity stakes to investors is that if your business loses money or goes broke, you probably will not have to repay investors a cent.

The loss of control in your business is probably the biggest disadvantage involved in selling equity stakes to fund your business. There are many examples where the founders of a business, who put years of their life into the company, are voted out of the company by investors. Be careful to consider whether the financing gain is worth the loss of control. The other main disadvantage is that equity investors will want to receive a portion of the business profits, taking away valuable company profits that could otherwise be reinvested into the company. Finally, because equity investors are co-owners, you have a duty to inform them of all significant business events, and they can sue you if they feel their rights are being infringed.

THIS CHAPTER IN ESSENCE

1. Common law includes all sources of law except for legislation.
2. Parliament is sovereign which is why it may pass any legislation, subject to the Constitution. If a delegated law is passed that is beyond the authority given, it is *ultra vires*.
3. Parliament comprises two houses: the National Assembly and the National Council of Provinces. Once a Bill is passed it goes to the State President for signature, after which it becomes law.
4. Roman-Dutch law was introduced when the Cape was colonised by the Dutch. Later, English law influenced our legal system and several branches of law.
5. To promote certainty in the law, our courts adopt the doctrine of precedent or *stare decisis*.
6. Our courts also use rules to interpret legislation.

QUESTIONS

Short questions (1–5 marks)

1. List two sources of South African law.
2. List four important legal principles set out by the Twelve Tables of Rome.
3. Describe the two systems of Roman law.
4. List the four parts comprising the *Corpus Juris Civilis*.
5. Name three influential Dutch authors who wrote commentaries on the Justinian Code.
6. List five advantages of *stare decisis* or the doctrine of precedent.
7. List three disadvantages of a strict application of the doctrine of precedent.
8. Explain the meaning of each part of the following citation: *Customer v Company (Pty) Ltd* 2008 (2) SA 367 (SCA) at 372F–H.

Paragraph questions (5 marks)

1. Define what is meant by common law.
2. What is the doctrine of precedent?

3. Outline the effect of customary law on modern South Africa.

Essay questions (10 marks)

1. Discuss how a Bill becomes an Act of Parliament.
2. Discuss ten rules applied by the court to interpret legislation.

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1 Sharrock, 22–23.

2 Constitution of the Republic of South Africa, 1996.

3 Fouché, 7; Hahlo and Kahn, 143–212; Havenga et al., 4; Sharrock, 24–28; Swanepoel et al., 3–4.

4 Constitution of the Republic of South Africa, 1996.

5 *Green v Fitzgerald and others*; *Fitzgerald v Green and others* 1914 AD 88.

6 Constitution of the Republic of South Africa, 1996.

7 Barratt, A and Snyman, P, *Researching South African Law*, www.llrx.com/features/southafrica.htm, 2004.

8 Ibid.

9 Ibid.

10 Fouché, 5; Hahlo and Kahn, 132–133.

11 Hahlo and Kahn, 329–578.

12 Nicholas, 1–59.

13 Source: Internet Medieval Sourcebook: Medieval Legal History, http://www.fordham.edu/halsall/sbook-law.html, accessed 13 February 2008.

14 Barratt, A and Snyman, P, *Researching South African Law*, www.llrx.com/features/southafrica.htm, 2004.

15 Ibid.

16 Ibid.

17 Interim Constitution Act 200 of 1993.

18 Constitution of the Republic of South Africa, 1996.

19 Barratt, A and Snyman, P, *Researching South African Law*, www.llrx.com/features/southafrica.htm, 2004.

20 Fouché, 8–9; Hahlo and Kahn, 213–215; Havenga et al., 5–6, 10–13; Sharrock, 28–31; Swanepoel et al., 4.

21 *Ex parte the Minister of Safety and Security and others: In re the State v Walters and another (unreported)* CCT 28/01; 21 May 2002.

22 Hahlo and Kahn, 260–281; Sharrock, 29.

23 Constitution of the Republic of South Africa, 1996.

24 Sharrock, 29.

25 *R v Venter* 1907 TS 910 at 915; *Shenker v The Master and another* 1936 AD 136 at 142; *Summit Industrial Corporation v Claimants against the Fund Comprising the Proceeds of the Sale of the*

MV Fade Transporter 1987 (2) SA 583 (A) at 596G-H; *S v Toms*; *S v Bruce* 1990 (2) SA 802 (A) at 807H-808A.

26 *Jaga v Dönges NO and another*; *Bhana v Dönges and another* 1950 (4) SA 653 (A) at 662G.

27 Hahlo and Kahn, 177–201.

28 Sharrock, 29.

29 Fouché, 9–10; Sharrock, 31–32; Swanepoel et al., 4–5.

30 *Van Breda v Jacobs* 1921 AD 330.

31 Sharrock, 32–33.

32 *Bhe and others v Magistrate, Khayelitsha, and others* 2004 (2) SA 544 (C); *South African Human Rights Commission and another v President of the Republic of South Africa and another* 2005 (1) SA 580 (CC).

33 Constitution of the Republic of South Africa, 1996.

34 Black Administration Act 38 of 1927.

35 Intestate Succession Act 81 of 1987.

36 Constitution of the Republic of South Africa, 1996.

37 Havenga et al., 6.

38 A full list of the abbreviations for the *South African Law Report* series can be found at: http://library.ukzn.ac.za/Libraries/Law/SOUTH_AFRICAN_LAW_REPORT_SERIES_list.sflb.ashx

39 Source: http://smallbusiness.findlaw.com/starting-business/starting-business-overview, accessed 3 January 2012. Copyright © 2011 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 3

Court structures and jurisdiction

'No man is above the law and no man is below it; nor do we ask any man's permission when we require him to obey it. Obedience to the law is demanded as a right; not asked as a favour.'

THEODORE ROOSEVELT (1858–1919)
26TH PRESIDENT OF THE UNITED STATES OF AMERICA

What is covered in this chapter

1 Structure of the courts
2 The Constitutional Court
3 The Supreme Court of Appeal
4 High Courts
5 Magistrates' courts
6 Small claims courts
7 Traditional courts
8 Special courts
9 Jurisdiction of the courts
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

The jurisdiction of a court will determine which court is allowed to decide a particular matter, and what may be claimed as a remedy. Typically smaller matters go before a lower court called a magistrates' court, and more significant cases are decided by a superior court called a High Court. Geography plays an important role in deciding which court will hear a matter; lower courts are restricted as to the amount of any claim, and as to the type of claim that may be heard. If there is a procedural irregularity or bias the losing party can apply to have the decision reviewed by a High Court; or, if the decision is wrong in law, the losing party may apply to have it appealed by a High Court and ultimately by the Supreme Court of Appeal.

The Constitutional Court is the highest court dealing with constitutional matters. Other special courts have also been established to hear cases dealing in particular areas only, for example the Labour Court will only hear matters involving employment disputes.

It is vital to understand which is the most appropriate court to hear a matter. This requires an understanding of the court's geographic, civil and criminal jurisdiction, and a clear understanding of the identities of the parties, the nature of the dispute, the amount being claimed and the remedy requested.

1 Structure of the courts

Courts may generally be grouped into two types: inferior courts (also known as ‘lower courts’), and superior courts (also known as ‘higher courts’). It is important to understand how the hierarchy works, because the decisions of some courts are binding on other courts.

The inferior courts (magistrates’ courts and small claims courts) are generally bound by decisions of the superior courts (divisions of the High Court) that are geographically within the same province.[1] All inferior and superior courts are bound by decisions of the Supreme Court of Appeal. All the courts are bound by decisions of the Constitutional Court.

2 The Constitutional Court

The Constitutional Court is the highest court over all matters relating to the interpretation, protection, and enforcement of the Constitution.[2] This means it makes the final decision on whether any law, or decision of the President or any organ of the State is constitutional. Because the Constitutional Court makes the final decision we say that it is the court of ‘final instance’ in constitutional matters.

The Constitutional Court was created by an interim constitution in 1993.[3] The interim constitution was ultimately replaced by the Constitution of the Republic of South Africa.[4] The Constitutional Court was created to determine how the relationship between the State and its citizens should be regulated. The Constitutional Court consists of the Chief Justice of South Africa, the Deputy Chief Justice of South Africa and nine other judges. It is situated in Johannesburg. Any matter that is heard by the Constitutional Court must be heard by a minimum of eight judges.

The authority of the Constitutional Court extends across the whole of South Africa, and its judgments are binding on all other courts, including the Supreme Court of Appeal and the High Courts.[5]

The Constitutional Court has jurisdiction to decide any constitutional matter referred to it in terms of the Constitution, or by a High Court, relating to the following:

- Any dispute over the constitutionality of any executive or administrative act, or conduct.
- Any inquiry into the constitutionality of any law, including an Act of Parliament.
- Any alleged violation of any fundamental right contained in the Bill of Rights in the Constitution. The Bill of Rights prohibits unfair discrimination against any person on any grounds, including race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language, and birth.

If any law, regulation, ordinance, or by-law infringes any constitutional rights, that piece of legislation may be struck down as unconstitutional. In this way, the rights of citizens are protected against abuse by the government of the day. For example, the Constitutional Court has declared that the State may not impose the death penalty or whip criminals, as this contravenes the constitutional protection of a citizen’s right to life and his or her rights against cruel and inhumane treatment.

Similarly, the State generally is not allowed to censor media or refuse adults access to political material or sexually explicit material, as this would deny citizens their freedom of choice. However, the Constitution may set limitations on rights. For example, the right of access to sexually explicit material may be limited to material other than that of child pornography.

For more details on the jurisdiction of the Constitutional Court, refer to the web-based chapter 33 on the Constitution of the Republic of South Africa, 1996.

3 The Supreme Court of Appeal

The Supreme Court of Appeal decides all appeals against decisions of the High Courts. It is the highest court in South Africa, other than the Constitutional Court.[6]

The Supreme Court of Appeal is located in Bloemfontein, and comprises a President and a Deputy President and 23 other judges of appeal. It is purely a court of appeal and has jurisdiction over the whole of South Africa. It is the highest court of appeal in all matters except constitutional matters. Its decisions are binding on all other courts. Any matter that is heard by the Supreme Court of Appeal must be heard by a minimum of three judges.

4 High Courts

Four branches of the High Court were initially situated in Pretoria, Cape Town, Bloemfontein, and Pietermaritzburg respectively (the former capitals of the four colonies). To cope with more cases as the population increased over time, additional branches of the High Court were established in some provinces. Thirteen branches known as ‘divisions’ of the High Court are now located in eight provinces. The 13 divisions of the High Court and their abbreviated names are set out in Table 3.1.

Table 3.1 *The names of the 13 divisions of the High Court*

Province	Name of High Court	Abb	Previous name	Abb
Eastern Cape	Eastern Cape High Court, Bhisho	ECB	Ciskei Division	Ck
	Eastern Cape High Court, Grahamstown	ECG	Eastern Cape Division	E
	Eastern Cape High Court, Mthatha	ECM	Transkei Division	Tk
	Eastern Cape High Court, Port Elizabeth	ECP	South-Eastern Cape Local Division	SE
Free State	Free State High Court, Bloemfontein	FB	Orange Free State Division	O
KwaZulu-Natal	KwaZulu-Natal High Court, Durban	KZD	Durban and Coast Local Division	D
	KwaZulu-Natal High Court, Pietermaritzburg	KZP	Natal Provincial Division	P
Gauteng	North Gauteng High Court, Pretoria	GNP	Transvaal Provincial Division	T
	South Gauteng High Court, Johannesburg	GSJ	Witwatersrand Local Division	W
Limpopo	Limpopo High Court, Thohoyandou	LT	Venda Division	V
North West	North West High Court, Mafikeng	NWM	Bophuthatswana Division	B
Northern Cape	Northern Cape High Court, Kimberley	NCK	Northern Cape Division	NC
Western Cape	Western Cape High Court, Cape Town	WCC	Cape of Good Hope Provincial Division	C

The province of Mpumalanga currently has no High Court and falls within the jurisdiction of the North Gauteng High Court in Pretoria. The Eastern Cape High Court operates from four places: Bhisho, Grahamstown, Mthatha and Port Elizabeth (each with its own separate geographic area); and the KwaZulu-Natal High Court operates from two places: Durban and Pietermaritzburg (each with its own separate geographic area).

Figure 3.1 *Jurisdiction of the High Courts by geographic area*

Each High Court is composed of a Judge President and, if the State President so determines, one or more Deputy Judges President, and as many judges as the State President may determine.

Cases dealt with by the High Court may be heard by one or more judges, depending on the nature of the proceedings. In criminal cases, the judge will sit with two assessors, who are not necessarily legally trained people, but who are experts or people skilled in the matters being considered. When appointing an assessor, factors such as the socio-political background of both parties, the nature and seriousness of the complaint, and the interests of both parties and the community at large, are taken into account.[7]

At least two judges will sit in an appeal from the magistrates' court. Where the appeal is from the High Court, three judges will preside.[8]

Each High Court has the same status as any other High Court. A High Court has jurisdiction only in its own geographical area over all persons residing or being in that area. It hears matters that are of such a serious nature that the lower courts would not be competent to make an appropriate judgment or impose a penalty. Except where minimum or maximum sentences are prescribed by law, their penal jurisdiction is unlimited and includes life imprisonment in certain specified cases.

Decisions of a High Court are binding on all magistrates' courts within that geographical area. When there are conflicting decisions of law between any two or more High Courts, a decision by the Supreme Court of Appeal will be binding on all courts.

The High Courts are governed by both the Supreme Court Act,[9] and the rules promulgated in terms of the Act.

'Circuit divisions' of the High Court are temporary mobile courts, each presided over by a judge of the High Court. At least twice a year these courts visit remote areas designated by the Judge President of the High Court concerned.

5 Magistrates' courts

The magistrates' courts are governed by the Magistrates' Courts Act[10] and the rules promulgated in terms of that Act. The Minister of Justice and Constitutional Development has divided South Africa into 13 magisterial regions consisting of 384 magisterial districts. Unlike the High Court, the ability of the magistrates' courts to hear cases or to impose penalties is limited by legislation. For this reason magistrates' courts are known as lower courts, or inferior courts. As at 2010, there were 384 magistrate's offices, 18 detached offices, 79 branch courts and 235 periodical courts in South Africa, with 1 914 magistrates.[11]

Cases dealt with by the magistrates' courts are heard by presiding officers called magistrates. Decisions made by magistrates are not published in law reports and have no effect as precedents.[12] This is because magistrates' courts deal with less serious cases than the High Courts. Magistrates' courts are bound by decisions of the High Court in the geographical area in which they are situated.

Each magistrates' court has jurisdiction in respect of people present in its geographical area, or matters arising within its geographical area. The magistrates' courts are governed by both the Magistrates' Courts Act[13] and the rules promulgated in terms of the Act.

There are two types of magistrates' court:

- **Regional magistrates' courts**: Regional magistrates' courts are established in each of the 13 regions. They deal with serious criminal cases, civil cases involving claims of between R100 000 and R300 000, and divorces. A regional magistrates' court can impose a maximum criminal sentence of up to 15 years' imprisonment or a fine of up to R300 000.[14]
- **District magistrates' courts**: District magistrates' courts are established in each of the 383 magisterial districts. They deal with less serious criminal cases and civil claims of up to R100 000. A district magistrates' court can impose a maximum criminal sentence of up to three years' imprisonment or a fine of up to R60 000. An accused person cannot

appeal to the regional magistrates' court against the decision of a district magistrates' court, only to the High Court.

The most one can sue for in the district magistrates' courts is R100 000 for an action arising from a liquid document or credit agreement, or R50 000 in all other cases. A person who wants to sue for more than this amount, for example R120 000 arising from a cheque, has the choice of either suing from the regional magistrates' court or the High Court for the full amount, or 'abandoning' R20 000 of the claim and suing for only R100 000 from the district magistrates' court.

6 Small claims courts

These courts were established by the Small Claims Courts Act[15] to deal with matters where the claim in dispute was quite small (currently the maximum amount is R12 000) and the parties were reluctant to incur the legal costs of expensive court cases.[16]

Only a natural person may sue in a small claims court; however, a juristic person may be sued. Litigants are not entitled to have legal representation and the parties must present their own cases. The presiding officer is called a commissioner, and conducts the proceedings in the way he or she deems fit. The commissioner is usually a practising advocate or attorney, a legal academic or other competent person who offers his or her services free of charge.

Witnesses can be called, but generally only the commissioner may cross-examine witnesses. Evidence can be submitted on oath orally or in writing, but rules of evidence are not kept to strictly. The unsuccessful party generally cannot be made to pay the costs of the successful party, which would be the case in other courts.

A small claims court cannot hear matters where the State is being sued or certain other matters, for example divorce, wrongful arrest, defamation, the interpretation of a will, or where an interdict is sought. Despite the fact that the amount of the claim may be less than R12 000, a plaintiff does not have to sue in a small claims court, and instead may choose to sue in a magistrates' court or even a High Court.

As at 2010 there were 206 small claims courts countrywide, of which 25 were designated to rural areas. The Department of Justice planned another 120 small claims courts by 2012.[17]

7 Traditional courts

An authorised African traditional leader or deputy may hear and determine civil claims arising from indigenous law and custom, brought before him or her by an African against another African within his area of jurisdiction. Courts constituted in this way were commonly known as ‘chief’s courts’. Litigants have the right to choose whether to institute an action in a traditional court or in a magistrates’ court.

Proceedings in a traditional court are informal. A litigant who is aggrieved with the decision of a traditional court may have the matter heard again in a magistrates’ court.

Jurisdiction may be conferred upon a traditional leader to try and punish an African person who has committed an offence under common law or indigenous law and custom, with the exception of certain serious offences specified in the relevant legislation. The procedure at such trials is in accordance with indigenous law and custom. The jurisdiction conferred upon a traditional leader and a magistrate does not affect the jurisdiction of other courts competent to try criminal cases.[18]

8 Special courts

Various legislation has created special higher courts and special lower courts for dealing with matters requiring specialised expertise.

8.1 Special higher courts

These include the following:

- **Labour courts**: The Labour Relations Act[19] provides for the creation of labour courts and a Labour Appeal Court to resolve certain issues regarding labour matters.
- **Court for Tax Appeals**: Hears appeals against decisions of the Commissioner for South African Revenue Services regarding income tax. The appeal is heard by a judge, an accountant with at least ten years' experience, and a representative of the financial community.
- **Court of Commissioner of Patents**: Hears appeals against decisions of the registrar of patents. The matter is heard by a judge of the Transvaal Provincial Division of the High Court.
- **Commercial Court**: This court is part of the South Gauteng High Court, Johannesburg, and provides a quick and informal adjudication of commercial matters. The judges are people with experience in commercial matters. The parties must jointly request the Judge President for access to this court.
- **Competition Appeal Court**: Three or more High Court judges hear appeals and reviews of decisions of the Competition Tribunal, established in terms of the Competition Act.[20]
- **Land Claims Court**: This court hears cases dealing with the return of land taken away during apartheid (land reform cases). It has its own rules and conducts proceedings informally and inquisitorially (where the judge asks witnesses questions directly, rather than through lawyers). The court can sit wherever it needs to, although its main office is in Randburg.

8.2 Special lower courts

These include the following:

- **Children's court**: Every magistrates' court is also a children's court, and deals with matters involving the adoption and maintenance of children.
- **Maintenance court**: This court investigates failure to pay maintenance, and makes orders for the payment of maintenance.
- **Equality courts**: These operate within the existing infrastructure of the magistrates' courts and High Courts. As at 2011 there were 184 equality courts nationally.[21] The person who makes a decision is called a 'presiding officer'. Anyone acting in his or her own interest or on behalf of another person or group may institute proceedings at the equality court.[22]

  Once a complaint is lodged by an 'applicant,' the clerk of the court considers the complaint and decides if it should be heard at the equality court, or at another tribunal.

  The person being sued is the 'respondent'. He or she must prove on a balance of probabilities that the conduct complained of: (1) has a legitimate purpose; (2) it achieves its purpose; (3) there are no other less restrictive and disadvantageous means to achieve the purpose; and (4) reasonable steps have been taken in the circumstances to redress the imbalance.

  The losing party may apply to have the decision reviewed, or appealed.

  Pillay v MEC for Education, KwaZulu-Natal and others [23]

  The governing body of a high school prohibited learners from wearing nose studs. The mother of a learner argued that the prohibition violated her daughter's constitutional right to practice the religious and cultural traditions of her choice, which took precedence over the school's code of conduct.

  The Equality Court held that the prohibition unfairly discriminated against the appellant, her daughter and their religious group and declared it null and void. It was not authorised by the South African Schools Act,[24] nor did it accommodate diversity. In addition it was arbitrary, unlawful, unreasonable and unjustifiable in an open and democratic society based on human dignity, equality and freedom.

- **Community courts**: South Africa has established community courts on a pilot basis to provide speedy resolution of certain types of community offences. These courts focus on restorative justice processes, such as

diverting young offenders into suitable programmes. Thirteen community courts have been established.[25]

- **Courts for income tax offenders**: In 1999, the South African Revenue Service opened a criminal courtroom in Johannesburg. The court deals only with cases of people who do not submit tax returns or who fail to provide information requested by officials. It does not deal with bigger cases such as tax fraud. Another two courts also operate to prosecute minor tax offences.[26]

9 Jurisdiction of the courts

Sometimes it is difficult to know which court should be used in respect of a particular action. The term ‘jurisdiction’ means the authority that a court has to decide a matter before it.

The High Court derives its powers from the common law, although some of its powers and functions are detailed in the Supreme Court Act.[27] Because these powers come from the common law, we say that the High Court has ‘inherent jurisdiction’.

The lower courts have no inherent jurisdiction, but only the powers specifically given to them in terms of the Magistrates’ Courts Act.[28] The magistrates’ courts, for this reason, are called ‘creatures of statute’.

Both of these Acts place territorial and other limits on the civil and criminal jurisdiction of the courts, so as to distribute the workload among the various courts.

Generally, jurisdiction is determined by three factors:

- Geographical area where the issue being litigated took place.
- Nature of the issue. This is also known as the ‘cause of action.’
- The presence of the legal subjects in the geographical area.

Cases in which an order is sought to declare invalid any legislation or any conduct of the State President, should be brought in a High Court. This is because a court of a status lower than the High Court may not enquire into or rule on the constitutionality of any legislation or any conduct of the President.[29] A magistrates’ court must decide matters before it on the assumption that legislation and conduct of the President are valid.[30]

Jurisdiction of the various courts is also limited in terms of the nature of the civil claim being made and the amount of compensation being sued for, and the type of criminal offence being heard and the maximum penalty that may be applied. This is illustrated in Table 3.2.

Table 3.2 *Jurisdiction of the courts in civil and criminal matters*

	Supreme Court of Appeal	**High Court**
Geographical area	The whole of South Africa.	Each division of the High Court has jurisdiction over a defined portion of a province of South Africa.
Appeal	May hear an appeal against any decision of any High Court, provided that leave to appeal is granted.	The High Court may hear an appeal against any decision of any magistrates' court within its geographic area, provided that leave to appeal has been granted.
Review	May not review any matter.	May review any matter.
Civil claim	Provided leave to appeal is granted, may hear an appeal against a claim of any amount (i.e. no maximum).	May hear a matter involving a claim of any amount (i.e. no maximum).
Type of criminal offence	Provided leave to appeal is granted, may hear an appeal against any outcome of a criminal trial.	May hear any matter involving any offence.
Penalties that may be imposed for a criminal offence	Unlimited.	Unlimited.

Regional magistrates' courts	**District magistrates' courts**	**Small claims courts**
South Africa is divided into 13 magisterial regions.	There are 384 magisterial districts in South Africa. The jurisdiction of a district magistrates' court is limited to its own magisterial district.	May hear only cases that occurred within a specified magisterial district.
May never hear any appeal.	May never hear any appeal.	May never hear any appeal.
May not review any matter.	May not review any matter.	May not review any matter.
May hear a civil claim of between R100 000 and R300 000, and divorces.	May hear a matter involving a claim of a maximum of R100 000. May not hear any matter involving a divorce or a dispute regarding the validity of a will or the mental capacity of a person.	May hear a matter involving a claim of a maximum of R7 000. May not hear any matter involving a divorce or a dispute regarding the validity of a will or the mental capacity of a person.

May hear any matter, except treason.	May hear any matter, except treason, murder, rape, terrorism, or sedition.	May not hear any matter involving any criminal offence.
May impose a sentence of up to 15 years' imprisonment or a fine of up to R300 000.	May impose a sentence of up to three years' imprisonment or a fine of up to R60 000.	May not impose any sentence or any fine.

9.1 Geographic area

Each High Court, magistrates' court and small claims court exercises jurisdiction over a limited geographical area, and care must be taken to ensure that proceedings are brought in the correct court that has the jurisdiction to hear the case.

Generally, a court will have jurisdiction to hear a matter if the defendant (or accused) lives within the geographical area for which the court is established, or is physically present in that area, or if the cause of action arose within that area. For example, if a contract was entered into and performance should have occurred within the area, then a court will have jurisdiction to hear a civil claim. Similarly, if a crime was committed within the area, then a court will have jurisdiction to hear the criminal matter. A court will generally also have jurisdiction if the person being sued or charged works within the area or owns property there.

There will be many cases in which the court (whether it is a High Court, a magistrates' court or a small claims court) of more than one area will have jurisdiction. In such cases, the party bringing the court case may choose whichever forum is the most convenient to him or her. Provisions exist for the person being sued or charged to apply to have the proceedings transferred to another court

where the proceedings may more conveniently be heard in another court.[31] The proceedings can also be transferred where undue expense or inconvenience will be caused to the person being sued or charged.[32]

9.2 Civil and criminal jurisdiction

Limitations on the jurisdictions of different courts to hear civil and criminal matters are set out in Table 3.2.

9.3 Review

A High Court with geographic jurisdiction may re-examine any decision or proceedings of any inferior court, or of any tribunal, board or officer performing a judicial or administrative decision-making function, if it is alleged that grave irregularity, bias, corruption, or illegality occurred during the course of the proceedings. This re-examination is known as a 'review'. Only a conclusion of law made by a lower court can be reviewed, not a finding of fact.

If satisfied that any grave irregularity, bias, corruption, or illegality occurred in the previous hearing, the High Court may send the matter back to be re-heard, or change the judgment or decision.

Melani v S [33]

Two unrepresented accused men were found guilty of various counts of theft. One appealed; the other did not.

Citing numerous instances of irregularities the High Court set aside both convictions and sentences in respect of both accused. In respect of the co-accused, who did not lodge an appeal, the court said that fairness required that it should use its inherent review powers to review his conviction and sentence as dictated by the interest of justice.

The irregularities committed by the regional magistrate included his failure to explain to the appellant the right to remain silent; failure to provide the appellant with written statements made by State witnesses; failure to allow the appellant to testify from the dock rather than the witness box; conducting an inspection *in loco* not to have a better understanding of the evidence but to make a credibility finding against the appellant; and taking sides with the prosecution against the appellant.

Matroos v S [34]

In another case involving the same magistrate, the High Court set aside the accused's conviction and his sentence, even though the appeal was lodged against sentence only, as the court said it had inherent powers of review to consider the merits of the appellant's conviction as well.

Some of the irregularities which rendered the trial unfair were that the regional magistrate did not explain to the appellant that he did not have to answer any questions from the bench at the stage of the explanation of the plea; the magistrate started to question the appellant before he had chosen whether he would explain his plea of not guilty; had not made it clear to the appellant that he had no obligation to say anything; had fully assumed the role of the prosecutor with the very first witness to be called by the State and continued much along the same line throughout the trial; took over the prosecutor's functions during examination-in-chief of some of the witnesses and also elicited inadmissible evidence in an entirely improper manner, such as by asking leading questions; showed gross impatience with the appellant's cross-examination, disallowing

a number of relevant and permissible questions in the process; and hardly allowed the appellant any reasonable opportunity to test the State case in cross-examination.

Limitations on the abilities of different courts to conduct reviews is set out in Table 3.2.

9.4 Appeal

An appeal is a process by which a higher court may reconsider a previous judgment in the same case. The court that first hears the trial, regardless of whether it was a magistrates' court or a High Court, is referred to as the court of 'first instance'.

One of the parties to a case may be dissatisfied with the decision. Written reasons for the dissatisfaction may then be submitted with a transcript of the case to a higher court.

The decision of a magistrates' court generally may be appealed against to the High Court with geographic jurisdiction. There is no automatic right to appeal against a decision of a High Court: in such a case an appeal can only be allowed to proceed if the High Court grants permission for this to happen. Limitations on the abilities of different courts to hear appeals is set out in Table 3.2. The structure of the court system on appeal is illustrated in Figure 3.2.

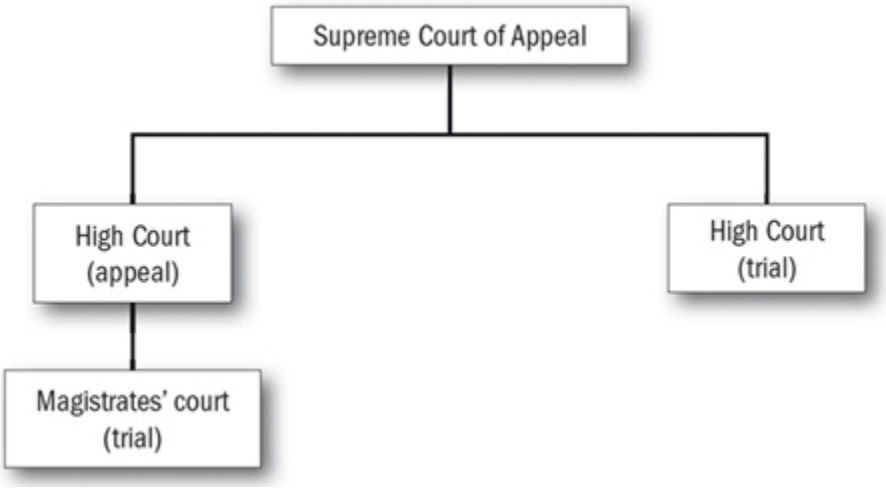

Figure 3.2 *The structure of the court system on appeal*

PRACTICALLY

SPEAKING

Why do new businesses fail?

It is estimated that about 50% of new businesses will close down in their first year of operation, and that over 80% will no longer be in business after five years. What are the main reasons why so many new businesses fail?

- **Inadequate planning**: The most important reason for such high rates of new business failure is poor planning, and failure to research the market adequately. An idea for a new business might seem amazing to the person who thought of it, but how realistic is the idea really? To plan properly, someone with a bright idea for a new business needs to work out if there is a market for the product or service, and how to tap into that market to make a profit. Because an idea is good does not mean that you will make a profit from it.
- **Lack of funding**: Where does someone who wants to start a new business get the money from to implement their plans properly? Some may have enough money themselves to do this; most people do not. You may need to borrow money from an investor or bank, or find someone to loan it to you. Borrowing money can cost a lot in interest, and this means that you may be paying off loans ahead of reinvesting money into the business. It is wise to consider how you will obtain your startup finance, and how much it will cost. This means that you will need a detailed business plan to set out to potential investors how the new business will be financed.
- **Time and effort**: Are you prepared to give up your current job and work on your new business with total commitment? For some people that would be very risky; they would want to work on their new business after hours or on weekends. However, you need to ask yourself whether this is enough time and effort to get the new business started. If you do not believe in your idea entirely, you may be setting yourself up for failure if you are not committed to your new business succeeding.
- **Cash flow**: It is not only important that your assets exceed your liabilities; it is also vital that you have money available to pay your bills. Customers who buy goods on credit can be very difficult for a new business. How are you supposed to pay your suppliers if your customers do not pay you? If people pay you late, or not at all, your new business can go under. You should always have some money available to pay your bills, and if you foresee a cash flow problem you should find additional funding and get professional advice from an accountant or a lawyer as soon as possible.
- **Employees**: A new business will typically have just one or two people doing everything – from unloading boxes to selling the goods. As your business grows, you will not be able to do everything yourself. It will be necessary to hire specialised skills to support you. This will mean that your business takes advantage of experts, and allow you the time to do what you do best – to grow the business, and not to administer it.

THIS CHAPTER IN ESSENCE

1 The inferior courts (magistrates' courts and small claims courts) are generally bound by decisions of the superior courts (divisions of the High Court) that are geographically within the same province. All inferior and superior courts are bound by decisions of the Supreme Court of Appeal.
2 All the courts are bound by decisions of the Constitutional Court, which is the highest court over all matters relating to the interpretation, protection, and enforcement of the Constitution.
3 The High Court derives its powers from the common law, although some of its powers and functions are detailed in the Supreme Court Act. Because these powers come from the common law, we say that the High Court has 'inherent jurisdiction'.
4 The lower courts have no inherent jurisdiction, but only the powers specifically given to them in terms of the Magistrates' Courts Act. The magistrates' courts, for this reason, are called 'creatures of statute'.
5 The magistrates' courts are governed by the Magistrates' Courts Act and the rules promulgated in terms of that Act. Regional magistrates' courts deal with serious criminal cases, civil cases involving claims of between R100 000 and R300 000, and divorces. A regional magistrates' court can impose a maximum criminal sentence of up to 15 years' imprisonment or a fine of up to R300 000.
6 District magistrates' courts deal with less serious criminal cases and civil claims of up to R100 000. A district magistrates' court can impose a maximum criminal sentence of up to three years' imprisonment or a fine of up to R60 000.
7 Only a natural person may sue in a small claims court; however, a juristic person may be sued. Litigants are not entitled to have legal representation and the parties must present their own cases.
8 Generally, jurisdiction is determined by the geographical area where the issue being litigated took place; the 'cause of action,'

and the presence of the legal subjects in the geographical area.

9 A review is when a decision of a magistrate is brought before a judge of the High Court with geographic jurisdiction if there are allegations of grave irregularities, bias, corruption, or illegalities that occurred during the course of the magistrates' court proceedings.

10 The High Court may hear an appeal against any decision of any magistrates' court within its geographic area, provided that permission or 'leave to appeal' has been granted.

QUESTIONS

Short questions (1–5 marks)

1. List 15 fundamental rights protected by the Bill of Rights.
2. Name five types of specialised courts.
3. List the three factors that determine the jurisdiction of the courts.

Paragraph questions (5 marks)

1. Discuss the jurisdiction of the Constitutional Court.
2. Identify the 13 divisions of the High Courts in South Africa and where they are located.

Essay questions (10 marks)

1. Discuss the civil and criminal jurisdictions of regional and district magistrates' courts.
2. Distinguish between a review and an appeal.
3. Discuss the types of jurisdiction of courts in South Africa.

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1 Fouché, 15–18; Sharrock, 29–31.

2 Havenga et al., 7; Sharrock, 29–31.

3 Constitution of the Republic of South Africa Act 200 of 1993.

4 Constitution of the Republic of South Africa, 1996.

5 Sharrock, 29–31.

6 Sharrock, 9–11.

7 Bekker et al., *The Criminal Procedure Handbook*, 6th ed, Butterworths: Durban 2003.

8 Sharrock, 11–12.

9 Supreme Court Act 59 of 1959.

10 Magistrates' Courts Act 32 of 1944.

11 South African Government Information website http://www.info.gov.za/aboutgovt/justice/courts.htm#05magistrate, accessed 17 September 2011.

12 Havenga et al., 9–10; Sharrock, 12–13; Swanepoel et al., 10–12.

13 Magistrates' Courts Act 32 of 1944.

14 Jurisdiction of Regional Courts Amendment Act 31 of 2008; *Government Notice* GN670 in *Government Gazette* 33418/29-7-2010.

15 Small Claims Courts Act 61 of 1984.

16 Fouché, 21; Sharrock, 13–14.

17 South African Government Information website: http://www.info.gov.za/aboutgovt/justice/courts.htm#05magistrate, accessed 17 September 2011.

18 Burger, *South Africa Yearbook 2003/4*, Yeoville: STE Publishers 2004.

19 Labour Relations Act 66 of 1995.

20 Competition Act 89 of 1998.

21 *Government Notice* 859 in *Government Gazette* 32516/28-8-2009.

22 Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000.

23 *Pillay v MEC for Education, KwaZulu-Natal and others* 2006 (6) SA 363 (Eq C).

24 South African Schools Act 84 of 1996.

25 South African Government Information website: http://www.info.gov.za/aboutgovt/justice/courts.htm#05magistrate, accessed 17 September 2011.

26 Ibid.

27 Supreme Court Act 59 of 1959.

28 Magistrates' Courts Act 32 of 1944.

29 Section 170 of the Constitution of the Republic of South Africa, 1996.

30 Section 110(2) of the Magistrates' Courts Act 32 of 1944.

31 Section 9(1) of the Supreme Court Act 59 of 1959.

32 Section 35(1) of the Magistrates' Courts Act 32 of 1944; section 13 of the Small Claims Courts Act 61 of 1984.

33 *Melani v S* [2005] 2 All SA 280 (NC).

34 *Matroos v S* [2005] 2 All SA 404 (NC).

Chapter 4

Officers of the court and the law, and the development of law

'I regard it as a duty which I owed, not just to my people, but also to my profession, to the practice of law, and to the justice for all mankind, to cry out against this discrimination which is essentially unjust and opposed to the whole basis of the attitude towards justice which is part of the tradition of legal training in this country. I believed that in taking up a stand against this injustice I was upholding the dignity of what should be an honourable profession.'

NELSON MANDELA (1918–)
FORMER PRESIDENT OF SOUTH AFRICA

What is covered in this chapter

1 Officers of the court and the law

2 Legal practitioners

3 Legal privilege

4 Organisations that assist in the development of the law

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

It is not easy to fight a court case. Emotions run high and the law can be confusing. Courts have complicated rules and procedures to follow to ensure fairness, and even cases that seem ordinary can take years before a court makes a decision. Sometimes the protection offered by the law can be frustrating because it may seem that dishonest people and criminals are allowed to get away with their actions.

It can take many years to become a properly trained lawyer who understands the way the legal system works, and who can work cleverly with the rules and procedures to ensure that their clients get the best legal advice and services. For this reason it is important that you understand the different types of legal practitioners who practice law in our system, and the different legal organisations that help to develop our law.

1 Officers of the court and the law[1]

The following roles each play a significant part in the operation of the legal system:

- **Attorney-general**: An attorney-general is appointed for each division of the High Court, and is responsible for criminal prosecutions subject to the control of the Minister of Justice. He or she controls the public prosecutors of the lower courts, and the State advocates of the superior courts.
- **Master of the High Court**: Each division of the High Court has a master who is responsible for the control of the administration of the estates of minors, insane persons, insolvent persons, and deceased estates. Their functions are regulated by legislation.[2]
- **Registrar of the High Court**: Each division of the High Court has a registrar who is in charge of the administration and running of that division. He or she also issues legal documents such as summonses, warrants and subpoenas. Other important duties of the registrar are that of taxing-master for that particular High Court division. Registrars also compile case lists and arrange available courts.
- **Registrar of Deeds**: A registrar is appointed to register rights over property and keep records of property in a particular geographical region.
- **Public prosecutor**: A public prosecutor is a public servant who presents the State's case in criminal cases. In the High Court he or she is qualified as an advocate and called the State advocate or State counsel.
- **Public defender**: A public defender is a legal practitioner who represents accused persons in criminal cases who cannot afford legal representatives.
- **Clerk of the magistrates' court**: A clerk is in charge of the administration of a magistrates' court. He or she issues legal documents such as summonses, warrants and subpoenas.

- **Sheriff**: A sheriff is responsible for the service of High Court and magistrates' court documents such as summonses, notices, warrants and court orders. Sometimes the sheriff will sell property to satisfy a judgment debt, and may arrest judgment debtors.

2 Legal practitioners

There is currently considerable pressure to reform the laws regulating the legal profession. Due to a number of reasons, including historical disadvantage, a significant number of unqualified legal advisers and legal practitioners are providing legal advice to the public for remuneration. However, their services are not regulated and the public is not protected against unethical conduct. The situation is currently the focus of much debate in the legal community. The Legal Practice Bill has been delayed for several years and is not due to be passed until 2013 at the earliest.

The legal profession is currently divided into two branches: advocates (who are specialists), and attorneys (who do legal work of all kinds). Both branches are subject to strict ethical codes.[3] The same person may not practice as both an attorney and as an advocate.

2.1 Advocates

The advocates' profession in South Africa is a referral profession. This means that a client approaches an attorney who, in turn, instructs an advocate. Advocates have no direct contact with clients. Advocates may also be called 'counsel'. They can be instructed or 'briefed' to take on cases by attorneys when a specialist skill is needed in a court case or in research into the law.

Advocates are organised into Bar associations or societies, one each at the seat of the various divisions of the High Court. The General Council of the Bar of South Africa is the coordinating body of the various Bar associations and maintains ethical conduct for advocates. The requirements for membership of a Bar are a Bachelor of Laws degree (LLB) obtained at a South African university, and completion of a one-year pupillage, which consists of a practical course during the first half and followed by the bar examinations and advocacy training skills towards the end.

Membership of a Bar is limited to advocates in private practice. Advocates are individual practitioners and never form partnerships. Members of the Bar must have offices called 'chambers' and they are bound by the rules of ethics of individual Bars.

Codes of ethical conduct apply to every person who joins the Bar and these are enforced by the Bar Councils. An advocate who transgresses the law or the code of conduct may be expelled from the profession by way of an application to the High Court. These codes regulate the ethical handling of a case, duties to the court, to attorneys, to clients and to other advocates, and the charging of fees which must be reasonable having regard to the financial capacity of the client and the complexity of the case.[4]

Van der Berg v General Council of the Bar of South Africa [5]

An advocate had practised for over 30 years. He had assisted a client in a criminal case drawing up an affidavit which was false. The advocate was appealing against an application of the General Council of the Bar to strike his name from the roll of advocates.

The court held that merely to suspect, or even firmly to believe, that evidence is false does not prevent an advocate from allowing his client to place the evidence before the court. Even if he believes positively that his client's evidence is false, he is entitled, and indeed obliged, to place it before a court if those are his client's instructions. The position is different if the advocate knows for a fact that evidence is false or misleading. An advocate has a duty not to deceive or mislead a court. An advocate breaches his duty to the court not only by permitting evidence to be given knowing it to be false, but also by failing to speak when he knows that the court is being misled.

Advocates can appear in any South African court. These include the Constitutional Court, the Supreme Court of Appeal, High Courts, the Labour and Labour Appeal Courts, Land Claims and Tax Courts and the magistrates' courts. Advocates appear in appeals in all superior courts in South Africa. They can also appear in trials and applications in the High Courts and other courts in any province. In addition advocates appear in arbitrations, which include commercial, building, engineering and employment arbitrations. Advocates are also instructed to provide written or oral opinions on matters involving southern African law.

Ex parte Ngwenya: In re Ngwenya v Society of Advocates, Pretoria, and another [6]

The court considered when is a person a 'fit and proper person' to be admitted as an advocate. The applicant admitted having a criminal record, being convicted on two counts of theft each for R500, and one count of defeating the ends of justice, committed while he was acting as a prosecutor in the magistrates' court.

He argued that he had been wrongfully convicted; alternatively, that he had been reformed.

The court held that reform could begin only when a person acknowledged that he had committed the wrongful act. He stated in the documents that formed part of his court

application that he had reformed; this contradicted his claim that he had been wrongfully convicted. If his character references relating to his reform were correct, his statement that he had been wrongfully convicted was untrue, which meant that he was not a 'fit and proper person' to be admitted as an advocate.

2.2 Attorneys

Attorneys are the business managers of cases and they decide when an advocate should be hired to act for a client. Attorneys are the lawyers that clients see first with their problems. Attorneys give general advice in the law. There is a law society for attorneys in each of the provinces. A practising attorney must by law be a member of at least one of these societies, which seek to promote the interests of the profession and maintain ethical conduct.[7]

The Law Society of South Africa is the coordinating body of the various independent law societies.

In terms of the Right of Appearance in Courts Act[8] attorneys may be heard in all of the lower courts and can also acquire the right of appearance in the superior courts. An attorney who wishes to represent his or her client in the High Court is required to apply to the registrar of a provincial division of the High Court. Such an attorney may also appear in the Constitutional Court. All attorneys who hold an LLB or equivalent degree, or who have at least three years' experience, may acquire the right of audience in the High Court.

The Attorneys Act[9] provides for several different routes for admission as an attorney. The typical route is that a person who intends to be admitted as an attorney and who has a four-year LLB degree must complete two years of practical training called 'articles of clerkship', and also pass the written and oral admission examinations set and marked by the relevant Law Society. The length of articles of clerkship can vary depending on additional legal training and whether the candidate attorney has a university degree or not.

The differences between attorneys and advocates are illustrated in Table 4.1.[10]

Table 4.1 *Attorneys and advocates*

	Attorney	**Advocate**
Academic qualification	The minimum requirement is a matric certificate with full university exemption.	The minimum requirement is a four-year LLB degree.
Apprenticeship	Must serve a period of practical training called 'articles of clerkship' as a 'candidate attorney' under the guidance of a practising attorney known as a 'principal'. The length of articles of clerkship for someone with a four-year LLB degree is normally two years, but can vary. It will be only one year if the candidate attorney attends the full-time School for Legal Practice for six months; it can be five years if the candidate attorney only has a matric certificate.[11]	Must serve six months' practical training called 'pupillage'. During this time he or she is known as a 'pupil' and serves under the guidance of a practising advocate known as a 'master'.
Examinations	After completing articles of clerkship, the candidate attorney must pass the written and oral examinations of the relevant Law Society. He or she then makes an application to the High Court for admission as an attorney.	After completing pupillage, the pupil must pass the written and oral examinations of the relevant Bar. He or she then makes an application to the High Court for admission as an advocate.
Application for admission	In considering whether the applicant is a 'fit and proper person' for admission, the High Court will examine written reports from the principal and other practising attorneys, any criminal record, and any objections by the Law Society to admission.	In considering whether the applicant is a 'fit and proper person' for admission, the High Court will examine written reports from the master and other practising advocates, any criminal record, and any objections by the Bar to admission.
Ethical conduct	Regulated by the relevant Law Society, to which every practising attorney must belong. There are currently three Law Societies in South Africa: Cape Law Society, Law Society of the Free State, and the Law Society of the Northern Provinces. The Law Society of South Africa is the coordinating body of the various independent law societies.	Regulated by the relevant Bar, to which every practising advocate must belong. The 'Bar' is the name traditionally used for Societies of Advocates. There are currently ten Bars at the seats of

		High Courts, all of which are affiliated to the General Council of the Bar of South Africa.
Instructions	Take instructions from members of the public or corporate clients.	May only be briefed by attorneys, and may not take work directly from (or be instructed by) members of the public or corporate clients.
Rights of appearance	May not appear in the small claims courts as litigants are not entitled to legal representation. May appear in the magistrates' court and the Labour Court. If able to comply with certain requirements, may appear in the High Court, but only in respect of certain matters such as uncontested divorces. May represent clients at any administrative tribunal.	May appear in any court, except the small claims courts as litigants are not entitled to legal representation. May represent clients at any administrative tribunal.
Practice	May practice on his or her own or in partnership with other attorneys.	Must practice on his or her own and not in partnership. Is allowed to share offices with other advocates to reduce expenses.

2.3 State law advisers

State law advisers give legal advice to Ministers, government departments and provincial administrations, as well as to a number of statutory bodies. In addition, they draft Bills and assist the Minister concerned with the passage of Bills through Parliament. They also assist in criminal and constitutional matters. State advocates and prosecutors have been separated from the Public Service in certain respects, notably the determination of salaries.

The State Attorney derives his or her powers from the State Attorney Act,[12] and protects the interests of the State in the most cost-effective manner possible. He or she does this by acting on behalf of the State in legal matters covering a wide spectrum of the law.

The State Attorney is involved in the drafting of contracts where the State is a party, and also acts on behalf of elected and appointed officials acting in the performance of their duties, for example civil and criminal actions instituted against Ministers and government officials in their official capacities.

3 Legal privilege

‘Privilege’ refers to information that is private between a client and a legal practitioner. Legal professional privilege is recognised by the courts to protect the confidentiality of communication between legal practitioners and their clients. Legal professional privilege is also referred to as ‘client legal privilege’ as the privilege is actually that of the client rather than the legal practitioner.

The purpose of legal professional privilege is to allow the client and legal practitioner to communicate freely about issues that are the subject of legal proceedings, or are anticipated as being the subject of legal proceedings.

Privilege protects the confidentiality of communication between a legal practitioner and the client when those communications are made for the dominant purpose of providing or obtaining legal advice, or legal services in anticipated or contemplated proceedings. Communication which meets the criteria of legal professional privilege cannot be required to be produced in court or used as evidence in legal proceedings.

S v Safatsa and others[13]

The court held that legal advice privilege was a fundamental principle of our judicial system. The proper functioning of the judicial system depended on the freedom of communication between legal advisers and their clients. The system could not work freely if legal practitioners or clients could be compelled to disclose what passed between them when legal advice was given or received.

4 Organisations that assist in the development of the law[14]

- **Rules Board for Courts of Law**: A statutory body that is empowered to make or amend rules for the High Courts, the Supreme Court of Appeal and the lower courts.
- **Justice College**: Presents the vocational training of all officials of the Department of Justice and Constitutional Development. It also presents training to autonomous professions such as magistrates and prosecutors.
- **Office of the Family Advocate**: The Family Advocate makes recommendations to serve the best interest of children in divorce actions or applications for the variation of existing divorce orders, regarding custody, access and guardianship.
- **Legal Aid Board**: The Legal Aid Board is an independent statutory body established in terms of the Legal Aid Act.[15] It provides legal services to poor people and legal representation to those who are constitutionally entitled to it.

  Criminal defence work makes up most of the legal services provided by the Board. Generally it only provides support in cases where a conviction would result in imprisonment for more than three years.

  In civil matters, a legal applicant is obliged to qualify in terms of a means test.
- **Office of the Public Protector**: In terms of the Public Protector Act,[16] this office is responsible for investigating any conduct in State affairs, or in the public administration in any sphere of government, that is alleged or suspected to be improper.
- **Magistrates Commission**: The Magistrates Commission was established to ensure that the appointment, promotion, transfer, discharge, or discipline against judicial officers in the lower courts takes place fairly. It also attends to grievances, complaints and misconduct investigations against magistrates.
- **SA Law Reform Commission**: The Law Commission researches and prepares documents for general information and comment. The object is to stimulate and activate debate.

- **Judicial Service Commission**: The Judicial Service Commission advises the State President on the appointment of judges, and also advises government on any matters relating to the judiciary or the administration of justice.

  When appointments have to be made, the Commission gives public notice of the vacancies that exist and calls for nominations. Suitable candidates are short-listed by the Commission and invited for interviews. Professional bodies and members of the public are afforded the opportunity to comment before interviews or make representations concerning the candidates to the Commission.

  The interviews are conducted as public hearings. The Judicial Service Commission makes its decisions in private. Its recommendations are communicated to the President, who makes the appointments.
- **Judicial Inspectorate of Prisons**: An independent office under the control of the inspecting judge whose object is to facilitate the inspection of prisons to report on the treatment of prisoners in prisons and on conditions in prisons.
- **South African Human Rights Commission (SAHRC)**: The aim of the Commission is to promote a culture and respect for human rights, to promote the protection, development and attainment of human rights, and to monitor and assess the observance of human rights in South Africa.
- **Commission on Gender Equality (CGE)**: The composition, functions and objectives of the Commission are outlined in the Commission for Gender Equality Act.[17]

  The main purpose of the CGE is to promote and protect gender equality as part of the pursuit of social justice and democracy. This is done by gathering information, conducting education and research, monitoring State and private sector policies and practices, and investigating complaints.

PRACTICALLY SPEAKING

Some questions to ask your attorney[18]

Attorneys will often provide a free or very low-cost consultation to discuss the details of your situation and give you an opportunity to ask some basic questions about the attorney. This meeting should not only help you decide whether to go forward with an attorney in general, but also whether you should proceed with that particular attorney. If you later decide to hire the attorney, you will go into a more detailed discussion of your case and ask more specific questions along the way.

You should have a list of questions in mind to ask during the meeting. Also, you should feel comfortable enough asking questions that relate to the attorney's expertise, experience, fees, special knowledge, and management of the case.

- **How long have you practiced law?** At a minimum, you will want to know about the attorney's expertise and whether the attorney is a veteran or beginner attorney. Your legal issue may be handled very well by someone who is a new graduate, and therefore cheaper to hire. Alternatively it may be complex and subtle, and would best be dealt with by an experienced attorney, even if the fees are higher.
- **What type of cases do you generally handle? What percentage of your practice is devoted to the practice area in question?** You will want to know about an attorney's expertise and how much of the attorney's practice is devoted to the topic area your legal issue falls within. For example, if you need help with an adoption case, you may wish to seek a family law attorney who has worked on previous adoption cases.
- **Who is your typical client?** This is an important, but often-overlooked question. For example, if you are an individual with a particular legal problem, but the attorney you are meeting with represents only corporations, this may not be the best attorney for you. Likewise, you may wish to know the financial background of some of the attorney's clients. This is because there may be different issues an attorney is used to dealing with when working with high net-worth individuals as compared to regular working people.
- **How many cases have you represented that were similar to mine?** Now is not the time to act shy. Feel free to ask about the attorney's track record, such as the number of cases won or settled, for example.
- **Other than a law degree, what kind of special training or knowledge do you have that might apply in my situation?** Some cases, like drunk driving and patent cases, require specialised training and knowledge for effective representation. Be sure to inquire whether your case fits into that category.
- **What are your fees and costs, and how are they billed? Will a portion or all of my case be handled by paralegals or legal assistants?** If so, ask about reduced costs. This step is obviously an important one. You will want to know whether you can afford the attorney's services and how you will be required to pay. This is also the time to ask about payment options and how often, and under what circumstances, you will be billed.
- **What is your approach or philosophy to winning or representing a case?** This can be important in two ways. First, if you are seeking an amicable divorce, for example, but the attorney is known to go for the kill in divorce cases, the attorney may not be the right one for you. Similarly, if you are looking for an aggressive attorney to handle an upcoming corporate merger, you will want someone who is not too timid.
- **Are there other ways for solving my legal problem?** It is important to ask the question at the very beginning whether there are any alternatives for solving your legal problem, such as through arbitration or some other out-of-court arrangement. A good attorney will generally inform you if your case can be handled through other less expensive and less time consuming means.

- **How will you let me know what is happening with my case?** Communication is key when working with an attorney. Ask the attorney how often and under what circumstances you will hear from him or her. You will want to know how your case is coming along and about other important dates. However, every time your attorney telephones you or writes to you, you will pay a fee. So it is important to get the balance right between sufficient communication and not being billed for every little thing.
- **What is the likely outcome in my case?** Generally speaking, it is a fair question to ask the attorney whether you have a good chance of winning your case. You are not looking for the right answer, just an honest one. For instance, if you are facing an uphill battle, you will want to know upfront from the attorney so you can prepare yourself for what lies ahead.

While the answers to questions you ask your attorney will vary widely, it is important to keep in mind that nothing should be taken as a guarantee. Instead, these questions should give you general knowledge of a specific attorney's experience and skill-level, and whether the attorney is a good fit for you.

THIS CHAPTER IN ESSENCE

1. Each division of the High Court has a registrar who is in charge of the administration and running of that division. He or she also issues legal documents such as summonses, warrants and subpoenas. Registrars also compile case lists and arrange available courts.
2. A clerk is in charge of the administration of a magistrates' court. He or she issues legal documents such as summonses, warrants and subpoenas.
3. A sheriff is responsible for the service of High Court and magistrates' court documents such as summonses, notices, warrants and court orders. Sometimes the sheriff will sell property to satisfy a judgment debt, and may arrest judgment debtors.
4. The legal profession is currently divided into two branches: advocates (who are specialists), and attorneys (who do legal work of all kinds). Both branches are subject to strict ethical codes.

QUESTIONS

Short question (1–5 marks)

1. List six officials of the court who contribute to the functioning of the legal system in South Africa.

Paragraph questions (5 marks)

1. Distinguish between attorneys and advocates.
2. What is 'legal privilege'?
3. What is the importance of ethics in the legal profession?

Essay question (10 marks)

1. Outline the roles taken by various organisations to assist in the development of our law.

1 Sharrock, 16–19.

2 Insolvency Act 24 of 1936; Estate Duty Act 45 of 1955; Wills Act 7 of 1953; Administration of Estates Act 66 of 1965; Close Corporations Act 69 of 1984; Intestate Succession Act 81 of 1987; Trust Property Control Act 57 of 1998; Companies Act 71 of 2008.

3 Burger, *South Africa Yearbook 2003/4*, Yeoville: STE Publishers 2004.

4 Website of the General Council of the Bar of South Africa, http://www.sabar.co.za, accessed 19 October 2011.

5 *Van der Berg v General Council of the Bar of South Africa* [2007] 2 All SA 499 (SCA).

6 *Ex parte Ngwenya: In re Ngwenya v Society of Advocates, Pretoria, and another* 2006 (2) SA 87 (W).

7 Website of the Law Society of South Africa, http://www.lssa.org.za, accessed 19 October 2011.

8 Right of Appearance in Courts Act 62 of 1995.

9 Attorneys Act 53 of 1979.

10 Fouché, 25–26; Sharrock, 19–20; Swanepoel et al., 16.

11 Attorneys Amendment Act 115 of 1993.

12 State Attorney Act 56 of 1957.

13 *S v Safatsa and others* 1988 (1) SA 868 (A).

14 Burger, *South Africa Yearbook 2003/4*, Yeoville: STE Publishers 2004; South African Government Information website at http://www.info.gov.za/aboutgovt/justice/structures.htm#jsc, accessed 15 November 2011.

15 Legal Aid Act 22 of 1969.

16 Public Protector Act 23 of 1994.

17 Commission for Gender Equality Act 39 of 1996.

18 Source: http://public.findlaw.com/library/hiring-lawyer/questions-to-ask-a-lawyer.html, accessed 3 January 2012. Copyright © 2011 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 5

Litigation, arbitration and mediation

'The law an eye for an eye makes the whole world blind.'

MOHANDAS GANDHI (1869–1948)
INDIAN LEADER AND ADVOCATE OF NON-VIOLENCE

What is covered in this chapter

1 Litigation
2 Criminal proceedings
3 Civil proceedings
4 Arbitration
5 Mediation
6 Enforcement of foreign judgments

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Law can be confusing for some people because they do not understand the procedures involved in taking someone to court, or in defending a claim. Courts have rules and procedures to ensure that both sides are treated fairly. There are different procedures and rules for criminal matters and for civil matters; sometimes during a court case it may be necessary to make a separate application to court to get information or force the other side to keep to the rules. Special procedures also exist for different types of matters, for example if one is suing for the amount owed on a cheque.

Instead of the rules and procedures involved in a court, parties can agree to have the dispute decided by an arbitrator, normally someone with experience in that type of case. Building and engineering disputes are often arbitrated because the parties can agree on someone who has appropriate construction experience to decide the matter, and they can also agree to have a process that is less complex and quicker than a typical court matter would be.

Sometimes the parties can agree to mediate a dispute, to see if it can be resolved between themselves without having to go to court.

It is important that you understand the procedures in a typical court matter, as well as the possible advantages of mediation and arbitration to resolving a dispute. You should also understand that a decision made by an overseas court can be enforced in South Africa.

1 Litigation

‘Litigation’ means to take legal action through a judicial process, normally a court. Generally, it can be divided into two forms: criminal litigation and civil litigation. As an alternative to a court process, parties involved in civil litigation may refer their dispute to arbitration (which is binding) or to mediation (which is not binding).

2 Criminal proceedings

Criminal law controls how people behave in society and what they are expected to do. In South Africa, the State brings a legal action against a person charged with a crime, who is called ‘the accused’. If the accused is convicted, the court passes a sentence to punish that person.

Before 1995 a person found guilty by the court could have been imprisoned, fined, whipped, punished, or even put to death. In 1995 the Constitutional Court declared both whipping and the death penalty unconstitutional.

Currently, the following sentences may be passed on a convicted person:

- Imprisonment.
- Periodical imprisonment. For example, going to jail every weekend.
- Declaration as a habitual criminal (regional magistrates’ court and High Court).
- Committal to an institution established by law.
- A fine (with or without imprisonment as alternative).
- Correctional supervision or a suspended sentence.
- Declaration as a dangerous criminal (regional magistrates’ court and High Court).
- A warning or caution.
- Discharge.

Courts often give ‘petty’ offenders community service, correctional supervision or suspended sentences, as alternatives to imprisonment. Where the law prescribes a minimum punishment, the court must sentence the offender to at least that penalty. However, where the offence does not have a minimum punishment prescribed, a court may postpone the passing of sentence for a period of up to five years and release the person convicted on one or more conditions.

The court may also suspend the sentence on certain conditions. If these conditions are not fulfilled, the offender may be arrested and made to serve the sentence. The court may then suspend the sentence again if the offender proves that circumstances beyond his or her control or any other good

reason prevented him or her from complying with the conditions of suspension.

A criminal case will typically involve several stages.[1] In the High Court or in a magistrates' court these stages will generally include the following:

- **Complaint made**: The South African Police Service investigates the matter and prepares a file called a docket.
- **Docket handed to the prosecutor**: The public prosecutor, who is the representative of the attorney-general, decides whether or not to prosecute.
- **Summons to appear in criminal court**: The accused person may be instructed verbally, or in a document, to appear in court on a certain day, or he or she may be taken into custody until the court date.
- **Charge sheet**: Charges are written on a charge sheet and read out to the accused in court.
- **Plea**: The accused must plead guilty or not guilty. If he or she refuses to plead, a plea of not guilty is entered.
- **Trial**: The public prosecutor leads evidence from witnesses and hands in documents as evidence. The accused may cross-examine witnesses. If there is insufficient evidence to sustain the charges, the accused may apply for a discharge. If granted, this amounts to a finding of not guilty. The accused may lead witnesses and hand in documents as evidence. The public prosecutor may then cross-examine. The magistrate may also ask questions. Finally, both sides may present legal argument.
- **Verdict**: The magistrate delivers a verdict. If the accused is found guilty, evidence may be led for mitigation of sentence.
- **Sentence**: The magistrate then sentences the guilty person by imposing a fine, imprisonment, suspended sentence, or requiring him or her to pay compensation or perform certain community service.
- **Appeal**: This is when the judgment of a prior court is reconsidered. An appeal is not automatic, and must be applied for in accordance with the rules of the relevant court.
- **Review**: This will be automatic in certain criminal cases. Where the magistrate has less than seven years' experience, a review will be automatic if the accused was sentenced to more than three months in prison or fines more than R5 000. Where the magistrate has more than seven years' experience, a review will be automatic if the accused was

sentenced to more than six months in prison or fined more than R10 000. If the review is successful, the higher court can confirm or change the judgment, correct the procedures, or may order a new trial.[2]

It is expensive to defend a criminal charge. Generally, all the costs incurred by the accused person must be paid for himself or herself, even if the accused is found not guilty or the case is dismissed, for example, through lack of evidence.

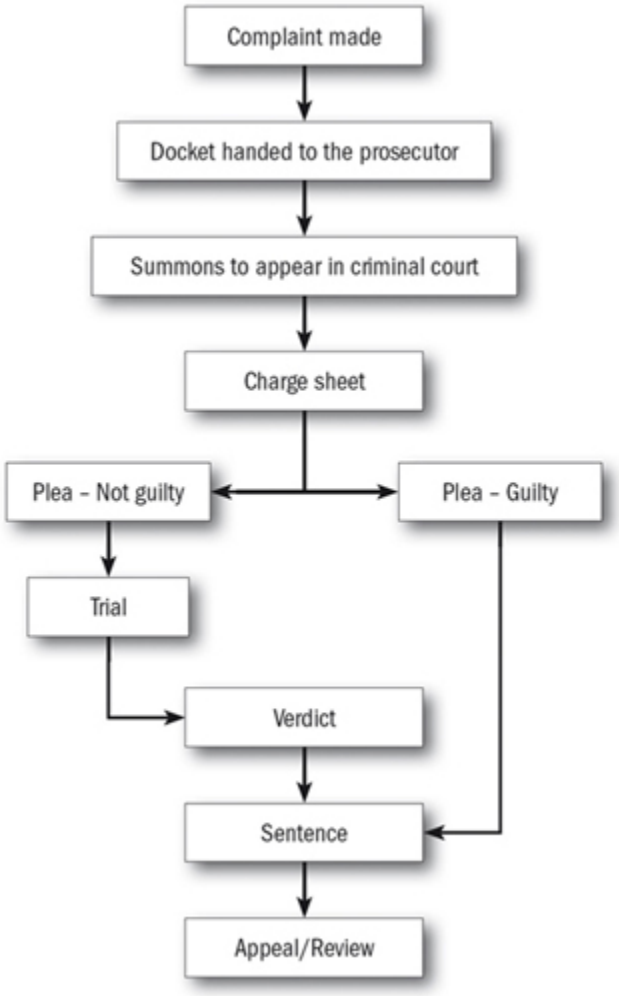

Figure 5.1 *Stages in a typical criminal case*

3 Civil proceedings

Civil law controls how people or groups of people behave towards each other. A person called the ‘plaintiff’ who feels that he or she has been wronged by another person brings a civil court case. The person being sued is called the ‘defendant’. If the plaintiff wins, the court will order the defendant to pay compensation, or to do something, or to stop doing something.

Three types of civil proceedings now exist in the High Courts and the magistrates’ courts:

- Provisional sentence proceedings.
- Trial actions.
- Application proceedings (also known as motion proceedings).

3.1 Provisional sentence proceedings

Where a plaintiff wants to sue on the basis of a ‘liquid document’, the cheapest and quickest way of getting judgment is to institute ‘provisional sentence proceedings’. This procedure is available in both the High Court and magistrates’ court rules.

A liquid document is a written document, signed by the debtor in which he or she unconditionally admits owing a specific amount of money to the plaintiff. It must be possible to calculate the amount of the debt from the document itself. For example, a cheque is a liquid document.

The creditor can issue a summons called a provisional sentence summons. The defendant must file an affidavit setting out his or her defence to the claim. If the defendant cannot provide an adequate written defence, the court will grant provisional sentence in favour of the plaintiff.[3]

The defendant must then make payment of the amount of the judgment. The plaintiff may have to provide security that the payment will be returned if the plaintiff does not win the trial. The defendant may then have the matter go to trial. If the defendant wins, the provisional sentence will be reversed.

3.2 Trial proceedings

Where the issue is one of dispute of fact, a trial action must be commenced. Evidence is led from witnesses, who may be cross-examined.

A civil case will typically involve several stages.[4] In the High Court or in a magistrates' court these stages will generally include the following:

- **Letter of demand**: A letter is sent, usually by registered post, to demand compliance with the terms of an agreement or enforcement of a right.
- **Summons**: A statement setting out the case and the remedy being sought is signed by the plaintiff, or the plaintiff's attorney or advocate, and is served on the defendant by the deputy sheriff. A time limit is given for the defendant to defend the claim.
- **Notice of intention to defend**: The defendant lodges this notice at court if he or she intends to defend the case, and also serves a copy on the plaintiff.
- **Default judgment**: If the defendant fails to file with the court within the time limit the notice of intention to defend, the plaintiff may apply for judgment against the defendant. Where the claim is not for a debt, evidence may be necessary to prove the amount of the claim.

  Once judgment has been given, the defendant has a limited time period to apply for 'rescission of judgment'. This means that the judgment is cancelled and the matter proceeds to be litigated. Rescission will only be granted if the defendant provides a good reason. For example, the defendant was in hospital, or the summons was not served on the right address.
- **Summary judgment**: If the defendant lodges a notice of intention to defend within the time limit, and the plaintiff believes this was done just to delay proceedings, the plaintiff may apply to court for 'summary judgment' against the defendant. This application will only be granted if the court agrees there is no valid defence to the claim, and where the claim is based on a cheque, a debt or specific amount of money, delivery of specified movable property, or ejectment from leased premises.
- **Request for further particulars**: After the defendant lodges a notice of intention to defend he or she may want more details about the case. The defendant then sends written questions to the plaintiff regarding issues raised in the summons.

- **Further particulars**: The plaintiff answers the written questions contained in the defendant's request for further particulars.
- **Plea**: This is the written defence of the defendant to the claim. The defendant must admit or deny all the material facts alleged in the summons.

  Instead of a plea the defendant may issue an **exception to the summons**. This is a document stating why the defendant believes that the summons was defective in that the allegations did not contain any legal grounds for claiming a legal remedy. In legal terms, the summons 'failed to disclose a cause of action'. For example, in a claim involving a motor vehicle collision, the summons leaves out an allegation of negligent driving. Similarly, the plaintiff may issue a written **exception to the plea** if he or she believes that there are no grounds in the plea which set out a legal defence. In other words, even if all the allegations were proved, the defendant would not legally be entitled to the remedy requested.

  The exception is set down for hearing and oral argument presented. If successful, the summons or plea must be amended. If unsuccessful, the matter continues with the original version of the summons or the plea, respectively.
- **Counterclaim**: The defendant may sometimes claim something from the plaintiff in return. For example, in a motor vehicle collision involving two vehicles, the defendant could allege that the plaintiff's negligence was a contributory cause of the collision and may then claim his or her repair costs from the plaintiff. A counterclaim may also be called a 'claim in reconvention'.
- **Request for further particulars to the counterclaim**: These are written questions to the counterclaim.
- **Further particulars to the counterclaim**: These are the answers to the questions to the counterclaim.
- **Plea in reconvention**: The plaintiff sets out a defence to the counterclaim.
- **Exception**: The parties may issue exceptions to the claim in reconvention or the plea in reconvention, respectively.
- **Close of pleadings**: All the above documents are referred to as 'pleadings'. Once the time for delivery of all pleadings has passed, the matter is 'ready to proceed to trial'. This stage is called *litis contestatio*.

- **Notices**: Either side may request the other to disclose relevant documents or evidence upon which their case relies. This process is known as ‘discovery’. Notices may also be issued to request information from the other side. For example, to submit to an expert medical or physical examination, or for financial accounts and documents.

  The general principle is that if any document or summaries of expert witnesses have not been disclosed to the other side before the trial commences, then none of that evidence may be used. This prevents the other side from being surprised and enables both sides to prepare their cases properly with all the relevant facts.
- **Application for trial date**: Court officials are asked when a court will be available to hear the matter.
- **Notice of set down**: The party who applied for a trial date serves a notice on both the opponent and the court. The registrar or clerk will reserve the court date and the matter is listed or ‘set down’ for hearing.
- **Trial**: Each party leads evidence from witnesses and produces documents to the court to prove its case. Witnesses may be cross-examined by the other party. An opportunity is also given to each party for legal argument to be presented.
- **Judgment**: The judge or magistrate decides which party is successful. If the court cannot decide, for example where insufficient evidence is led to allow the court to come to a finding in favour of one party or the other, it may grant ‘absolution from the instance’. This means that the court cannot decide. In effect, this means that no one wins and the matter is thrown out of court. The matter does not always end there – it is possible in some cases for the plaintiff to return to court at a later date with additional evidence.
- **Appeal**: This is when the judgment of a prior court is reconsidered. The prior court is known as the ‘court of first instance’ or the court *a quo*.

  An appeal is not automatic. Permission must first be applied for, and is called ‘leave to appeal’. The court whose judgment is to be appealed must first be approached for leave to appeal. If granted, the appeal process can be started. If refused, the party wanting to appeal a magistrates’ court decision may apply to the High Court for the necessary leave to appeal; a party wanting to appeal a High Court decision must apply to the Supreme Court of Appeal for the necessary permission.

The party who is seeking the appeal is known as the appellant; and the party against whom the appeal is sought is known as the respondent. The appeal court will decide the matter on the written transcript of the trial court of first instance, and on oral argument presented to it. Generally an appeal will only be granted if the appeal court believes that there is a possibility that the decision of the prior court could be wrong.

At common law, launching an appeal automatically suspends the judgment or order appealed against. This may be varied by the court on application – the onus is on the party who seeks to execute on a judgment or order as to why the judgment or order should be executed before the appeal is concluded. The court will consider the potential of irreparable harm being suffered by the respondents if leave to execute was granted, compared to that which would be sustained by the applicants if leave was to be refused.

- **Review**: It is possible to apply for a court decision to be looked at again by a higher court to ensure that the case was conducted in accordance with procedural requirements. This is known as a 'review'.

  Grounds for review include: the decision was outside the scope of the relevant legislation or *ultra vires*; the court lacked the necessary jurisdiction to hear the case; there was a gross irregularity with regard to the proceedings; or the presiding officer had an interest in the matter or displayed bias or malice. If the review is successful, the higher court can confirm or change the judgment, correct the procedures, or may order a new trial.

  In certain criminal cases conducted in the magistrates' courts a review by a judge is automatic and does not have to be applied for: if the accused was not represented by a legal practitioner and sentenced to more than six months in prison or fined more than R10 000; if the accused was not represented by a legal practitioner and sentenced to more than three months in prison or fined more than R5 000 and the presiding officer has worked for less than seven years as a magistrate.
- **Costs**: The court will normally require the unsuccessful party to pay a portion of the legal costs of the successful party.

3.3 Application or motion proceedings

‘Motion proceedings’ are simply an application of some sort being made to the court. Where there is no dispute of fact (that is, the facts are agreed but there is a dispute of law), then an applicant can start motion proceedings and evidence is given by ‘affidavit’. An affidavit is a written statement signed in front of a commissioner of oaths. The person signing the affidavit is known as the ‘deponent’ and is asked to swear an oath or solemnly promise that the contents of the affidavit are, to the best of the deponent’s knowledge, both true and correct.

The person making the application is called the applicant and the person against who the order is sought is called the respondent.

A ‘notice of motion’ is a written notice to the respondent that an application will be made to the court for a certain order. Dates are given by court officials for the proposed hearing, depending on whether the application is unopposed or opposed. The notice of motion must also have an affidavit supporting the application.

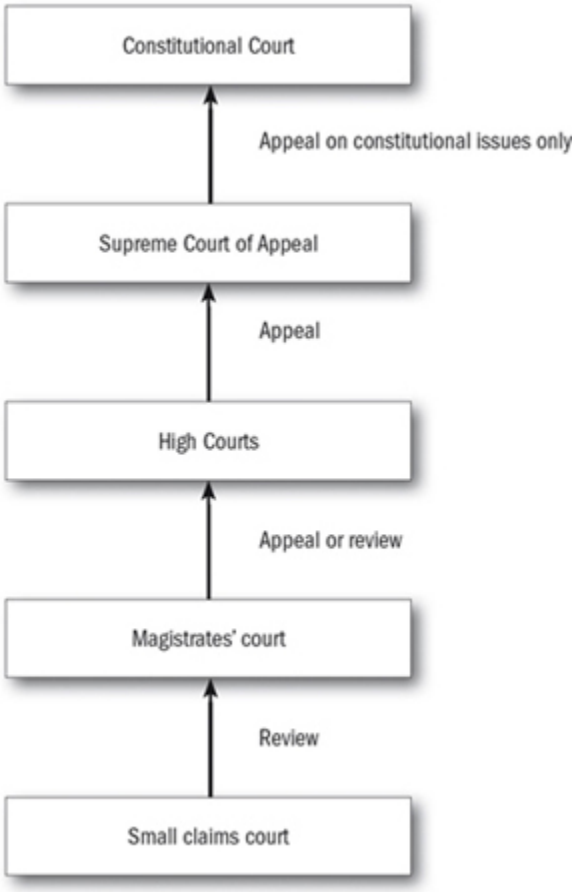

Figure 5.2 *Appeal and review procedures*

The respondent is given a date by which to file an 'opposing affidavit' and the applicant can respond with a 'replying affidavit'. On the date the application is heard in court, the law is argued by legal practitioners. The court makes its decision based solely on the affidavits and without oral evidence from witnesses.

There are five categories of cases that must be dealt with by application proceedings:[5]

- Cases in which the proceedings are required by statute.
- Cases involving claims for damages where the amount claimed is not in dispute (liquidated damages).
- Cases in which urgent relief is sought.
- Cases in which no relief is sought against any other person. Here, the procedure to be followed will always be by way of motion proceedings in the form of an *ex parte* application. There will be no respondent

before the court, and the only party will be the applicant. For example, an application for admission as an attorney or an advocate.

- Cases where there is no material dispute of fact between the parties.

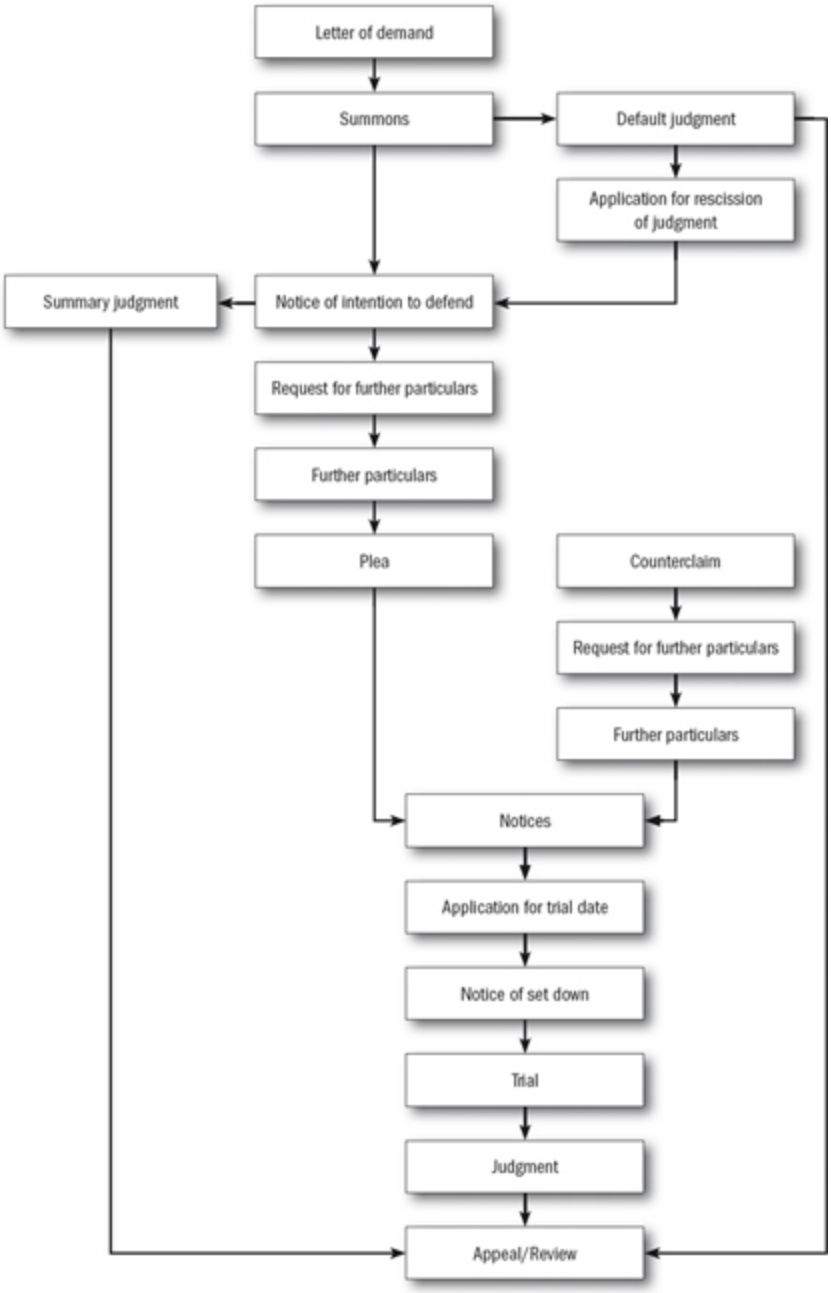

Figure 5.3 *Stages in a typical civil case*

3.4 Costs

It is expensive to take someone to court or to defend a claim. If the magistrate or judge makes a decision as to which party wins, costs may be awarded on a scale published in the *Government Gazette* from time to time. This means that the unsuccessful party may expect to pay the costs of the other party on this scale, which is known as costs 'as between party-and-party'. These costs are fairly limited. Only certain items can be charged for, and then only at particular maximum rates.

Occasionally a 'punitive costs order' may be made by a court. This is clear message that the court is saying the losing party is wasting everyone's time with the legal action. These costs are less limited but are still in accordance with the particular scale 'as between attorney-and-client', as also published in the *Government Gazette.* Where the court wants to make a punitive costs order against the attorney or advocate personally for misconduct, for example for not arriving at court one day without any excuse, it can make an order for the legal representative personally to pay the wasted costs of both sides. This is known as an order as to costs 'on the legal representative's own account' or *de bonis propriis*.[6]

In reality, legal charges by attorneys and advocates can come to far more than those set out in the scale, and so even winning at court might not get you all your actual costs back. Only where a client, in writing, has agreed to pay whatever the attorney charges will the client be liable for costs 'as between attorney-and-own client'. These costs may be unlimited.

In all these cases an itemised bill may be prepared. On application, the bill is checked by an official at the court called a 'taxing master' to ensure that all fees and disbursements are appropriate and are in accordance with the relevant scale.

3.5 Civil proceedings in the small claims court

Legal practitioners are not allowed to represent their clients in small claims courts.[7] For this reason, the proceedings are kept simple. There is only one form of procedure, and no choice between trial and motion proceedings.

The plaintiff starts the process by handing or posting by registered post to the defendant a written demand. This must allow the defendant at least 14 days, calculated from the date of receipt of that demand by the defendant, to satisfy the plaintiff's claim. If the demand is not met, the

plaintiff must deliver a summons to the clerk of the court, together with proof of the service of the 14-day demand upon the defendant.

The clerk issues the summons, which may then be served personally on the defendant by the plaintiff or by the sheriff of the court. No further pleadings are necessary, although the defendant may, prior to the hearing, lodge with the clerk of the small claims court a written statement setting out his defence, and give a copy of that statement to the plaintiff.

At the hearing, the presiding commissioner for small claims conducts the hearing and may allow a party to put questions to another party or to any witness.

4 Arbitration

This process involves an agreement by parties that a dispute be decided by one or more arbitrators, instead of being decided in a civil court.

4.1 Arbitration and litigation compared

- **Speed**: Arbitration is meant to be quicker and easier than litigation. This is not always true. Some arbitrations can take longer to run and be more expensive than court cases.
- **Confidentiality**: Possibly the best advantage of arbitration is that it can be a private and confidential arrangement between the parties. Arbitration generally involves little publicity, and so may be preferred by the parties. Litigation is normally conducted in public in a court, and the documents become a matter of public record and knowledge.
- **Formality**: The parties to an arbitration can influence the degree of formality and procedures used.
- **Technical expertise**: Sometimes the parties may want a technical expert to decide a matter, rather than a legal expert. One of the benefits of arbitration is that the parties can agree to appoint technical experts as arbitrators.
- **Flexibility**: Arbitration is generally a more flexible process than litigation that is conducted according to the Rules of Court. Parties to an arbitration can agree on the rules and procedures that would apply, as long as the process is generally within the parameters outlined in the Arbitration Act.[8] Sometimes parties may agree to conduct an arbitration in accordance with the High Court Rules; at other times they may agree to conduct the arbitration in accordance with the rules of the Arbitration Foundation of South Africa.
- **Precedent value**: The award of an arbitrator has no precedent value.
- **Costs**: Parties to an arbitration must pay the arbitrator a fee, whereas the courts are provided by the State.
- **Finality**: Whereas an arbitration award is final, the judgment of a court may be taken on appeal.

4.2 The Arbitration Act

The Arbitration Act[9] governs all written agreements that refer a matter to arbitration. The Act provides that certain matters cannot be referred to arbitration.[10] These are matrimonial matters; any matter to determine legal status or capacity; criminal matters; or unlawful matters.

***Taylor v Kurtstag NO and others*[11]**

The applicant failed to pay maintenance for his three minor children in terms of a court order. He and his wife agreed to refer the dispute to a Jewish religious court. That court made an excommunication order against him, and issued a decree that the Jewish community shun him. He applied to the High Court for an order interdicting the religious court from issuing or publishing the decree.

The High Court dismissed the application. It held that the decision of the religious court relating to disputes about custody, maintenance and proprietary consequences of the marriage between the applicant and his wife was expressly prohibited by the Arbitration Act[12] and therefore invalid.

Many contracts contain arbitration clauses that must be complied with in the event of any dispute. However, when the entire agreement is void, the arbitration clause similarly will be void, and a disputing party then must litigate in court.

***Lufuno Mphaphuli and Associates (Pty) Ltd v Andrews and another* [13]**

The Constitutional Court had to decide if the Constitution applied to private arbitration, particularly the right to have a dispute decided in 'a fair public hearing'. The dispute concerned a contract to electrify rural villages. The parties had agreed to refer the dispute to arbitration, but problems arose when the arbitrator made a decision. The losing party claimed that the arbitrator had held secret meetings with the winning party, and had sent letters that were not shared with both parties. This meant that the hearing was not fair and impartial.

The court held that this provision of the Constitution did apply to private arbitration; however, that the parties to private arbitration waive their rights to a public hearing. As long as their agreement to refer the dispute to arbitration was not *contra bonos mores*, the parties forego the Constitutional rights they would otherwise enjoy. Further, private arbitration was not normally conducted in public. On the facts, the arbitration had been conducted fairly. While the conduct of the arbitrator was not perfect, it did not give rise to a gross irregularity.

4.3 Appointment of an arbitrator

Sometimes two or more arbitrators can be agreed upon, or even more with an umpire in the case of deadlock. In the absence of an agreement between the parties, only one arbitrator may be appointed. Most agreements contain

provisions for a mutually agreed upon outsider to make the appointment of the arbitrator. For example, the parties may agree to nominate the President of the Law Society of the Northern Provinces to make the appointment. In the absence of that type of clause, it is possible for a party to make an application to a court to appoint an arbitrator.

Once appointed, the arbitrator must hear both sides, and decide the matter on the basis of the evidence presented. Normally the parties will agree on the procedures to be used, and will prepare terms of reference to assist the arbitrator to reach a decision. These are normally in point form, and set out the facts the parties agree upon and the issues they want the arbitrator to decide upon.

The arbitrator decides the time, date, and place of the proceedings. The arbitrator can require the parties to distribute relevant documents to one another and to prepare documents setting out their versions, and also can require inspections of goods or property. The arbitrator will normally examine witnesses, and allow cross-examination.

Witnesses can be required to attend to give evidence in the same way that they can be compelled in any civil court action. Commissioners can also be appointed to take evidence from any person outside the country, and evidence may be received by affidavit.

Normally the arbitrator will be entitled to seek opinions from outside legal experts to assist in determining a point of law. The decision on that point of law will be binding and no appeal will be possible on that point. A party may make application to a court to require the arbitrator to seek a legal opinion.

Section 15 of the Arbitration Act[14] entitles an arbitrator to continue with arbitration proceedings in the absence of one of the parties.

***Vidavsky v Body Corporate of Sunhill Villas*[15]**

An arbitrator continued with the proceedings where the absent party only received notification of the proceedings on the morning they started.

The court held that because both parties were not present, and because one party had not received timeous notice of the arbitration proceedings, the arbitrator lacked jurisdiction. This resulted in the proceedings and award being invalid and therefore void.

Without express provisions in the agreement to refer a matter to arbitration, it is difficult to remove an arbitrator from appointment. Normally the

consent of all the parties is required. In the absence of that consent, a court may set aside the appointment on good cause, such as dishonesty or bias on the part of the arbitrator, although this is very difficult to prove.

Syphus v Schoeman[16]

An arbitrator awarded a high proportion of an estate to one of a group of heirs. One of the unsuccessful heirs objected to the appointment of the arbitrator, who was related to the spouse of the successful heir.

The court held that the disgruntled heir had known of the relationship prior to the appointment of the arbitrator. The relationship in itself did not prove actual bias by the arbitrator, and the application to remove him failed.

Not even the death or insolvency of a party has the effect of terminating the appointment of the arbitrator.

The arbitrator's decision is known as an award. The award must be in writing, and made within four months of the end of the proceedings. The award may be made an order of court, and enforced in the same way as any court judgment.

4.4 Remitting an arbitration award

Within six weeks of publication, the parties may agree to send the award back to the arbitrator to enable the matter to be reconsidered, and a fresh or further award to be made. This is known as remittal, and must be in writing.

The court may remit an award if there is a good reason. This is known as ‘good cause being shown’, such as if the award is incomplete or exceeds the terms of reference; material new evidence has been found that could not be produced before; or the arbitrator admits that a material mistake was made.[17]

A court will not remit an award where the arbitrator has fully considered a point, even if the arbitrator made an error in his or her decision.

4.5 Setting aside an arbitration award

An award made in terms of the Act is final and cannot be appealed against. However, in limited circumstances, it is possible to apply to court to set the award aside.[18]

This can be done for any of the following reasons:

- **Misconduct on the part of the arbitrator**: The arbitrator conducts himself or herself improperly, or in a way that is incompatible with his or her function of ensuring a fair and impartial hearing, such as when bias, corruption, or gross prejudice is involved. An example of such misconduct is when evidence is heard in the absence of a party.
- **Gross irregularity in the proceedings**: The arbitrator must carry out duties in a way that ensures the fair administration of justice between the parties. An example of a gross deviation from acceptable judicial standards is the refusal to allow a party to call witnesses. Not every irregularity is of such a serious nature that it results in a party not having their case fairly heard. Arriving at the right decision because of the wrong reasons does not amount to a gross irregularity.
- **Excess of powers used by the arbitrator**: The arbitrator is required to confine himself or herself to the terms of reference, and may not decide an issue that has not been referred. An example of an excess of power is where the arbitrator has exceeded powers assigned to make an award.[19]

- **An award obtained improperly**: For example if the arbitrator takes a bribe from one of the parties to decide the matter in the favour of that party. Even if a witness lies giving testimony, a court will not allow the award to be reviewed unless it is proved that the false statement was both material and influenced the arbitrator in reaching a decision.

Kannenberg v Gird [20]

Two arbitrators had to decide a dispute between two attorneys who had entered into a partnership agreement that was later ended by the one partner. The dispute related to the proper way of calculating the remaining partner's share of the profits. Each partner appointed an arbitrator but the arbitrators were not able to agree. They referred the matter to an umpire. The umpire, without consulting the arbitrators, then made an award.

The court referred to the case of *Société Franco-Tunisienne D'Armenent-Tunis v Government of Ceylon*,[21] a decision of the Court of Appeal in England. In that case the arbitrator based his award on a basis completely different to the submissions made to him by the parties. The English court held that the arbitrator should have allowed the parties to make submissions to him on the point on which he decided the case. He never did so. The court set aside the umpire's award on the basis that an irregularity occurred in the proceedings.

An arbitration award may only be challenged because of a procedural defect by means of a review. If an irregularity in the procedure results in unfairness or injustice, the award may be set aside. The award cannot be challenged because the decision was wrong, by an appeal. A mistake of fact or of law that was not made negligently by the arbitrator will not be allowed as a basis for setting the award aside.[22]

Once they have agreed to arbitration, the parties are bound to the award. The Act provides that an arbitration award may be enforced in the same way as a court judgment. This is done by making an application to court to have the award made an order of court.

Hyperchemicals v Maybaker Agrichem [23]

An award was made by an arbitrator and the dissatisfied party applied to court to have the award set aside on review. It was claimed that the arbitrator had 'legally misconducted' himself in relation to his duties. This was because he had exceeded his powers by failing to apply South African law correctly to resolve the dispute; and the award was based on evidence which was false. The applicant did not claim that the arbitrator had been dishonest.

The court had to decide whether 'legal misconduct' can mean actual misconduct within the meaning of the Act. As no reliance was placed on dishonesty, or actual

misconduct, the court had to determine whether there was legal misconduct, which is a term of English law and which is foreign to South African law. The court held that misconduct must be interpreted in its ordinary sense, and that a genuine mistake of law or fact cannot constitute misconduct as long as the arbitrator has given fair consideration to the matter. For misconduct to be grounds for setting aside an award, there had to be some wrongful or improper conduct on the part of the arbitrator.

Steeledale Cladding (Pty) Ltd v Parsons NO and another [24]

Two parties entered into an agreement for the supply of goods. The arbitrator found against the claimant on an issue never addressed at the hearing. The arbitrator had also never given the parties the opportunity to make submissions to him on this issue.

The court held that there had to be improper conduct on the part of the arbitrator for his award to be set aside on the basis of misconduct. There had to be actual misconduct. Legal misconduct would not be sufficient to set the award aside. However, where the proceedings were defective, and a gross irregularity was committed in the way the arbitration was conducted, then the court would be prepared to set aside the award.

In this case the court held that the dispute should be sent for re-hearing to a new arbitration.

5 Mediation

5.1 Mediation defined

Mediation is a process in which a neutral person facilitates communication between people in a dispute to help them reach a mutually acceptable agreement. Mediation is an informal process that allows people to resolve their dispute without any legal proceedings.

5.2 Mediation is different to arbitration

Mediation is sometimes also known as conciliation, or alternate dispute resolution. This is because it is an alternative to litigation.

Mediation can be used whenever someone has a dispute that could interfere with a business or personal relationship. For example, businesses that have strategic alliances may use mediation to resolve differences that their contracts did not contemplate, or to separate amicably. It can also be an alternative to a court action or arbitration for both businesses and individuals.

Unlike arbitrators in an arbitration, mediators do not decide cases. They have no power to impose a resolution of the dispute on the parties. They can offer different perspectives, help parties to articulate their priorities, re-frame the dispute, and assist the parties to negotiate a settlement. But they cannot tell parties what to agree to.

There is no record made of the mediation. It is a private process. What is said during the mediation is usually confidential. This should be clarified at the start, however. Generally, offers made to settle the case in mediation are not admissible in court. Other things that are said in mediation may not be protected. An attorney can draw up a mediation agreement which, when signed by both sides, prohibits disclosure of what was said in the mediation. Some mediators require the parties to sign a confidentiality agreement before they begin the mediation.

While a party may choose to mediate without an attorney being present, it is generally not a good idea. An attorney representing a party at the mediation can give advice on different options. While the party decides

what terms he or she is willing to agree to, the party will benefit from the attorney's advice and experience, and also have the benefit of his or her explanation of the legal consequences of any proposed agreement. Even if all the parties agree to mediate before launching any court action, having advice from an attorney makes sense. Any agreement reached in the mediation may have legal consequences.

There is a significant variation in the cost of mediation, depending upon the nature of the dispute and the way the dispute got to mediation. In cases where the parties want a professional mediator, they can expect to split the costs equally.

A party can choose a mediator who is a specialist in the field of the dispute, a specialist in dispute resolution, or who is both an expert in the subject matter of the dispute and an expert dispute resolver. Obviously, most people would choose someone who is both an expert in the field and in dispute resolution. While professional mediators are likely to charge more fees, they often may require fewer days, or help the parties fashion a better solution, and so can be very cost effective.

If the dispute is relatively small, it is usually better to choose someone who is an expert dispute resolver, rather than an expert in the subject matter.

In addition to their attorneys, the parties can bring anyone who will be useful to them in deciding whether the terms of a settlement are acceptable. If the parties are going to want to talk to their spouses or partners before deciding whether to agree to a settlement, they should bring their spouses or partners. If a party does not have any authority to settle for their company, they should bring someone who does.

5.3 How mediation works

A typical mediation starts on a date set by agreement between the parties and the mediator. The parties and their attorneys meet with the mediator for an opening session. The mediator explains the process he or she will be using and what is expected of everyone. Then the parties each tell their side of the dispute and the mediator asks questions to be sure he or she understands. The joint meeting usually breaks up into two separate meetings, or 'caucuses'.

The mediator then talks to each side in the caucus in an attempt to learn what is motivating the dispute, what the underlying issues are, and where

there are areas for movement from established positions. The mediator may ask more penetrating questions than in the joint session, since what goes on in caucus is confidential and not conveyed to the other side. The mediator may offer to try different proposals on the other side to see what the response might be. The parties do not have to take responsibility for any position the mediator is trying out, because it is not their position – only a mediator's attempt at moving the process along.

Ordinarily, the mediator moves between the parties, helping them invent new possibilities, trying out ideas, and narrowing the differences.

A successful mediation ends in an agreement that resolves the underlying dispute. The attorneys for the parties will draw up a written agreement that embodies all the main points of what has been agreed to. Both parties will sign this agreement and the dispute is ended. If properly drafted, the agreement can be enforced by a court.

5.4 Litigation, arbitration and mediation compared

Table 5.1 *Characteristics of litigation, arbitration and mediation*

	Litigation	Arbitration	Mediation
Decision-making authority	Jurisdiction determined by law.	Parties decide to submit their dispute to arbitration (often through contractual arbitration clause).	Parties agree to mediate.
	Jurisdiction is determined by the circumstances of the case.	Parties choose the location.	Often takes place in neutral territory.
	Courts are limited to cases that fall within their jurisdiction.	Arbitrator decides on disputes submitted to him or her.	Mediator decides whether or not to take cases submitted to him or her.
	Decisions made by judge.	Decisions made by arbitrator.	Decision made by parties.
	Can be appealed with cause.	Rarely can be appealed.	Parties can decide not to settle.
Procedure	Open to the public.	Confidential.	Confidential.
	Adversarial.	Adversarial.	Cooperative.
	Process determined by procedural laws.	Flexible process.	Flexible process.
	Fixed set of procedures.	Parties decide the ‘rules of the game’.	Parties and mediators determine ground rules.
Characteristics of third party involved	Judge is pre-appointed.	Arbitrator is selected by the parties.	Parties select a mediator.
	Judge often lacks technical expertise.	Arbitrator is expert on the issues.	Mediator is process expert; may or may not be substance expert.
	Judge is a disinterested third party.	Arbitration panels often include partial as well as non-partial arbitrators or one non-partial arbitrator.	Mediator can be outsider-neutral or insider partial. If insider partial, he or she may work with an outsider-neutral.

Institution	Permanent.	*Ad-hoc* panels.	*Ad-hoc*.
End of process	End determined by procedural requirements.	Parties can determine an end date (fast track arbitration).	Ends once cooperative agreement is reached, or parties decide not to settle.
	Win-lose solutions.	Win-lose solutions (unless arbitrator negotiates a win-win outcome).	Win-win solutions.
Enforcement	Established enforcement mechanism.	National regulations provide enforcement mechanism. International arbitration often lacks an established enforcement mechanism.	Implementation of agreement depends largely on the parties' goodwill, but the court may enforce in some circumstances.
	Decision subject to review (unless it is a decision of the High Court).	Award conclusive, final and binding. Right of appeal is the exception. May be subject to review.	No appeal once settled; other process can be used if no settlement is reached.

6 Enforcement of foreign judgments

A foreigner who wins a court case in a court outside South Africa may want to enforce the judgment in South Africa because the defendant lives in South Africa and has assets in South Africa.[25] South African courts do not re-examine the merits of the case.

Certain requirements must be met before a South African court will enforce a foreign judgment.

- The judgment must be final. If an appeal is underway, the South African court may decide whether or not to enforce the judgment or to stay the proceedings pending the outcome of the appeal.
- The foreign court must have had jurisdiction over the defendant in terms of South African law. South Africa will only recognise the jurisdiction of the foreign court in limited circumstances, such as where the defendant lived in the geographic area of the foreign court's jurisdiction, or where the defendant agreed to the jurisdiction of the foreign court.
- Enforcement of the foreign judgment must not be contrary to South African public policy or to the rules of natural justice. Punitive damages awarded by foreign courts have long been regarded as contrary to South African public policy. The South African court may also refuse to enforce a foreign punitive damages award if it is so exorbitant that to enforce it would be contrary to South African public policy. 'Punitive damages' means the amount of the judgment exceeds the amount determined as compensation for loss actually sustained.

PRACTICALLY

SPEAKING

Ten things to think about before starting your new business

If you are considering starting up a new business, here is some basic advice:

1 **Think about the reasons for setting up the business**: Starting up a new business is a major event in your life and will cause a lot of upheaval. For your new business to succeed you will need a lot of time, money and effort. Other aspects of your life will be affected, and you will need to budget the time you spend and keep up to date with all the administration.

It is really important to face the facts and think carefully about whether the lifestyle will suit you. Do you really have the courage to make the difficult decisions on your own, or do you prefer the relative comfort of working for someone else?

2 **Business structure**: Before you open up for business you have to decide on the structure for your business – will you trade under your own name as a sole trader, together with other people in a partnership, or do you want limited liability and to trade as a company? Your rights and duties are different under each structure, so think about your choice carefully, and consult an accountant before making your decision.

3 **Talents and abilities**: Think about where your true talents and abilities lie, and work out where you are weak or unskilled. Ask significant people in your life for their views. To be a truly successful businessperson, you need to know your strengths and your weaknesses, so that you can hire people with the right skills to assist you where they can be most beneficial.

4 **Finances**: Lack of money and poor cash flow are the biggest causes of new business failure. Plan conservatively when calculating your finance requirements, and make sure that you get paid by people who owe you money.

5 **Competitors**: Be very cautious about businesses in competition with you. Research how they run their business, and why they do the things they do. Speak to their employees, their customers, their suppliers and people who have done business with them. Find out what they do well, and what they do not do so well.

6 **Buyers**: Find out who will be buying your product or service. Be careful about competitors in your area – it is not a smart idea to have too many businesses all selling the same thing too close by.

7 **Business plan**: The process of working out your business plan helps to clarify your objectives and strategies to run your business. It is also a document that is vital if you want to convince investors to put money into the business, getting a loan from the bank, or to get a partner to commit resources to help you succeed.

8 **Employees**: You cannot do everything all by yourself. There will come a time when you simply are not able to do it all, and you will need additional people to help you. Your job is to make certain that you employ the right people with the right skills at the right times and places to grow your business.

9 **Get professional advisers**: Accountants and lawyers can be the best friends of new businesses. They understand the risks of situations and how to address immediate issues. By obtaining their input and advice early, you are able to plan to meet the challenges that will be inevitable in any new business startup.

10 **Know your market**: Customer attitudes and habits grow and change over time. What is fashionable or popular one month may be outdated by the end of the year, so it is important to know and understand what the market wants to spend money on; what could succeed and what would not.

THIS CHAPTER IN ESSENCE

1. Criminal law controls how people behave in society and what they are expected to do. In South Africa, the State brings a legal action against a person charged with a crime, who is called ‘the accused’. If the accused is convicted, the court passes a sentence to punish that person.
2. Civil law controls how people or groups of people behave towards each other. A person called the ‘plaintiff’ who feels that he or she has been wronged by another person brings a civil court case. The person being sued is called the ‘defendant’. If the plaintiff wins, the court will order the defendant to pay compensation, or to do something, or to stop doing something.
3. There are three types of civil proceedings in the High Courts and the magistrates’ courts: provisional sentence proceedings; trial actions; and application proceedings (also known as motion proceedings).
4. Arbitration is a process that involves an agreement by parties that a dispute be decided by one or more arbitrators, instead of being decided in a civil court. The Arbitration Act governs all written agreements that refer a matter to arbitration.
5. Mediation is a private process that is an alternative to litigation. Mediators have no power to impose a resolution of the dispute on the parties. They can offer different perspectives, help parties to articulate their priorities, re-frame the dispute, and assist the parties to negotiate a settlement.

QUESTIONS

Short questions (1–5 marks)

1. List five types of penalty that may be imposed by the court when convicting a person of a criminal offence.
2. List the three types of civil proceedings that exist in the High Courts and the magistrates’ courts.
3. List five categories of cases that must be dealt with by application proceedings.

4. Distinguish between three types of ‘costs’ that may be awarded in a civil case.
5. List eight factors to distinguish between arbitration and litigation.
6. List three reasons for the remission of an arbitration award.
7. List four reasons to set aside an arbitration award.
8. List three requirements for the recognition of judgments of foreign courts.

Paragraph questions (5 marks)

1. Describe the typical stages in a criminal case.
2. Draw a flow chart to demonstrate the stages in a criminal case.
3. Describe the typical stages in a civil trial.
4. Draw a diagram to demonstrate the stages in a civil trial.

Essay questions (10 marks)

1. Distinguish between criminal proceedings and civil proceedings.
2. Distinguish between mediation and arbitration.

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1 Fouché, 21–23; Sharrock, 20–22.

2 Section 302 of the Criminal Procedure Act 51 of 1977.

3 *Allied Holdings Ltd v Meyerson* 1948 (2) SA 961 (W); *Dickinson v South African General Electric Co (Pty) Ltd* 1973 (2) SA 620 (A).

4 Fouché, 21–23; Sharrock, 20–22.

5 *Room Hire Co (Pty) Ltd v Jeppe Street Mansions (Pty) Ltd* 1949 (3) SA 1155 (T) at 1161–1163.

6 *Makuwa v Poslson* 2007 (3) SA 84 (T).

7 Section 7(2) of the Small Claims Courts Act 61 of 1984.

8 Arbitration Act 42 of 1965.

9 Arbitration Act 42 of 1965.

10 Gibson, 8; Havenga et al., 219–220; Sharrock, 556.

11 *Taylor v Kurtstag NO and others* [2004] 4 All SA 317 (W).

12 Arbitration Act 42 of 1965.

13 *Lufuno Mphaphuli and Associates (Pty) Ltd v Andrews and another* CCT97/07 [2009] ZACC 6.

14 Arbitration Act 42 of 1965.

15 *Vidavsky v Body Corporate of Sunhill Villas* [2005] 4 All SA 201 (SCA).

16 *Syphus v Schoeman* 1923 CPD 113.

17 Sharrock, 561.

18 Havenga et al., 229; Sharrock, 561–563.

19 *Adamstein v Adamstein* 1930 CPD 165.

20 *Kannenberg v Gird* 1966 (4) 173 (C).

21 *Société Franco-Tunisienne D'Armenent-Tunis v Government of Ceylon* [1959] 3 All ER 25.

22 *Dickenson and Brown v Fishers Executives* 1915 AD 166.

23 *Hyperchemicals v Maybaker Agrichem* 1992 (1) SA 89 (W).

24 *Steeledale Cladding (Pty) Ltd v Parsons NO and another* 2001 (2) SA 663 (D).

25 Wakefield, R, Foreign Judgments in South Africa, *International Werks* vol 7, Johannesburg: Werksmans 1996.

PART B: BASIC PRINCIPLES OF CONTRACT

What happens if you break your agreement?

CHAPTER 6	Formation of a valid contract – *What procedures must be followed before we can have a valid contract?*
CHAPTER 7	Lawfulness of contract – *What happens if our agreement is against the law?*
CHAPTER 8	Capacity to contract – *I did not understand the consequences of what I was doing*
CHAPTER 9	Serious intention to contract – *It was not meant to be taken seriously*
CHAPTER 10	Communication – offer and acceptance – *Did we both think of the agreement in the same way?*
CHAPTER 11	Certainty of terms of contract – *Is it clear what we are each supposed to do?*
CHAPTER 12	Reality of consent – *You tricked me and exploited my weakness*
CHAPTER 13	Possibility of performance – *Am I able to do what is required by the contract?*
CHAPTER 14	Common contractual provisions and third

	parties to a contract – *Can I get someone else to replace me in the contract?*
CHAPTER 15	Termination of contract and remedies – *What can I do to make you comply with the agreement?*

Chapter 6

Formation of a valid contract

'A verbal contract isn't worth the paper it's printed on.'

SAM GOLDWYN (1879–1974)
AMERICAN FILM PRODUCER

What is covered in this chapter

1 Introduction
2 Definition
3 Formalities
4 Essential, automatic and additional terms of contract
5 Void and voidable contracts
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Contracts are fundamental to people's daily lives. Agreements are constantly being entered into by individuals with other individuals, and by businesses with other businesses, to sell or buy goods and services, and to create rights and duties. When we buy food, we enter into a contract of sale; when we work at a job we are engaged under a contract of employment; when we rent a house or a building we have a contract of lease. The list is endless; without enforceable contracts, business could not exist.

It is important that we understand what a contract is, and how all the essential elements of a contract must be present in any agreement for it to be considered a valid and enforceable contract. Sometimes the agreement we make does not contain all the essential elements of a contract, and the agreement may then be void or voidable.

1 Introduction

A contract is an agreement binding in law between persons in which they promise to do something, or not to do something, or to deliver something.[1]

The law respects the rights of people to agree or contract about almost anything and will generally enforce these contracts, provided they are not illegal, immoral or impossible to perform.

Although in theory a contract is based on agreement or a ‘meeting of the minds’, in practice it is difficult to know when people really have agreed. The law adopts an objective approach. This means that if a person acts in such a way that a reasonable outsider would believe that that person is in agreement with something, the law will take it that he or she actually did agree.[2]

2 Definition

A contract may be defined as a lawful agreement made by two or more persons within the limits of their contractual capacities, with the serious intention of creating a legal obligation, communicating that intention without vagueness to each other, and being of the same mind as to the subject matter, to perform positive or negative acts which are possible of performance.[3]

There are seven essential parts to this definition. The seven following chapters in this book will examine each of these parts in greater detail.

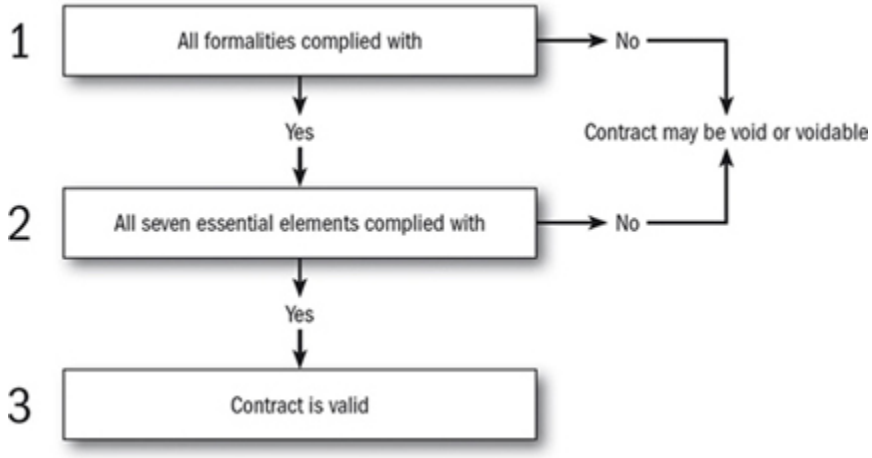

Figure 6.1 *Requirements for a valid contract*

3 Formalities

A formality is a process or formal step that must be complied with for the validity of certain contracts.

The general rule is that no formalities are required. Valid contracts can be made orally, in written form, or even by conduct.[4] As long as the intention of the parties is communicated clearly, then an oral contract is generally as valid as a written one.[5] Written contracts, however, are easier to prove in court than oral contracts.

Formalities may include the following:

- **Putting the contract in writing**: The parties or the law may require the contract to be in writing.[6] Sometimes it may be necessary to have the contract signed by the parties or their properly authorised representatives.

  If the contract must be in writing, then all the material terms must be written. They must be sufficiently detailed so that no extra evidence is required by the court to establish the material terms of the agreement.

Goldblatt v Freemantle[7]

An oral agreement was made between two people to buy and sell some lucerne every month. Both parties agreed that the agreement should be in writing. The arrangement was that the seller would send a letter to the buyer, and the buyer would confirm the terms in another letter. The seller sent the letter, and for several months sent the lucerne to the buyer. After six months the seller sent another letter to the buyer, requesting confirmation of the deal. The buyer wrote back, but did not mention the deal. The seller then notified the buyer that he would not supply any more lucerne until he received written confirmation. The buyer then said he was going to cancel the contract and sue for damages.

The court held that the parties had agreed that the contract would not be binding until it was in writing, and therefore no valid contract had come into existence.

If any party later believes that the written document does not reflect the intention of the parties, that party may apply to court to correct the document. This process is called ‘rectification’.[8]

The court, however, will not grant rectification where any third party will be adversely affected by the change. Rectification of a document will

be allowed in circumstances where the document correctly reflects the words the parties intended to use, but the document does not include the parties' common intention that forms a critical part of the overall contract. The court will allow a written contract to be rectified, not because of the parties' mistake as to what was written, but as to its effect.[9]

The courts will not allow rectification to validate a contract that is void.[10]

- **Signed by witnesses**: It may be necessary for one or more persons to act as witnesses to the signatures of the parties to the contract.
- **Notarial execution**: The contract must be signed, stamped and registered by a specialist attorney called a notary public. For example, this is required for antenuptial contracts.
- **Registration**: Copies of the contract must be lodged with a government department. This is required for title deeds and long leases, as well as for the formation of companies.

Formalities may be self-imposed or imposed by statute. With self-imposed formalities, the parties may agree during negotiations that no binding contract shall come into existence between them until their agreement is in writing.[11]

If one does not comply with a statutory formality the agreement may be void, or it may be valid but unenforceable, or it may be valid but the parties may be liable for an offence.

Examples of formalities imposed by statute include the following:

- The Alienation of Land Act[12] requires the sale of land to be in writing, and the contract must be signed by the parties or by their agents acting on their written authorities. The writing must adequately describe the property sold to enable it to be identified. If this formality is not complied with the contract will be void. The Act also requires the agreement to contain information telling the buyer of a cooling-off period. If this is not included, the contract is voidable.

Just Names Properties 11 CC and another v Fourie and others[13]

The sellers signed two blank pieces of paper in a contract for the sale of land.

The court held that the Alienation of Land Act[14] required that all material terms of the agreement must be in writing for it to be valid. The requirements of the Act were not complied with and so the agreement was void.

- Lay-by agreements under the Sale and Service Matters Act[15] must be in writing and signed by both parties. If not, the parties may be liable for an offence.
- An agreement to sell or to construct a home must be in writing and signed by the parties, and comply with the provisions of the Housing Consumer Protection Measures Act.[16] If this is not done, the contract is still valid but the builder is not allowed to get a deposit for the construction of the home.
- Long leases (ten years or more) require no formalities to be binding between the parties, but they cannot be enforced against third parties unless registered against the title deeds of the property. In terms of the Deeds Registries Act,[17] a lease must be signed, stamped and registered by a notary public before it can be registered.
- The National Credit Act[18] requires all credit agreements to be made on paper or stored electronically. If not, the agreement is still valid but the credit provider may be liable for an offence, which could include a fine or cancellation of their registration.
- Suretyship contracts are required by the General Law Amendment Act[19] to be in writing, and must be signed by or on behalf of the surety.

Other contracts requiring formalities are antenuptial contracts, apprenticeship contracts, and leases of rights to minerals.

4 Essential, automatic and additional terms of contract

The ‘essential terms’ of contract are the characteristic key terms that must be agreed on for the particular type of agreement to be held effective and binding. These terms may sometimes be called *essentialia.*

Other terms arise automatically by operation of law in the form of rights and duties owed by the parties to each other. These may be called *naturalia.*

The parties might also agree on additional incidental terms to govern their agreement. These terms may be called *incidentalia.*[20]

Table 6.1 *The meaning of essential, automatic and additional incidental terms of contract*

	Explanation	**Example**
Essential terms (*essentialia*)	These are the minimum key terms on which the parties must agree to put the contract into a particular category.	In a contract of sale, the parties must agree on the delivery of a thing to a person in exchange for a price.
Terms arising by operation of law (*naturalia*)	By law these terms form part of the contract. The parties do not need to specify them in a contract because they are automatically included.	In a contract of sale, the buyer will have undisturbed possession.
Additional incidental terms (*incidentalia*)	These terms may be included specifically into a contract by the parties for their own convenience. It is not necessary to add these terms for the contract to be valid, but sometimes people prefer to have a comprehensive agreement with all the requirements specified.	Payment will be made to bank account number 123456 at ABC Bank within 30 days.

5 Void and voidable contacts

It is important to distinguish between void contracts and voidable contracts.[21] These differences are illustrated in Table 6.2.

Table 6.2 *Void and voidable contracts*

	Void contract	**Voidable contract**	**Valid contract**
Nature	This type of agreement tries to create legal obligations between the parties, but does not do so because of a fatal defect. The defect must be so severe that it is as if the parties had never reached agreement and the contract had never come into existence.	This type of agreement has a flaw that entitles the aggrieved party to choose whether to treat the contract as valid or not.	No flaws. The contract complies with formalities and all seven essential elements.
Example	Certain unlawful contracts, or an agreement reached by mistake, or one in which performance was impossible at the beginning.	A contract concluded without true or voluntary agreement, such as through misrepresen tation, duress or undue influence, or where performance becomes impossible after the contract has been entered into.	Any contract that complies with all requirements.
Legal consequences	The contract has no legal existence at all. It is completely unenforceable and a nullity. It creates no rights or duties at all, and may be disregarded.	The contract is valid and enforceable until set aside by a court.	The contract is valid and enforceable by a court.
Enforcement and remedies	Neither party can enforce a void contract. However, certain common-law remedies may apply. Provided that the void contract was not illegal, a party who has performed may generally recover their performance on the basis of unjustified enrichment, by using a remedy called the *condictio indebiti*. The court may apply this common-law remedy where one party has received a benefit unfairly at the expense of the other, and	Normal contractual remedies apply in the event of any material breach. The defect allows the aggrieved party to choose to enforce the contract (and possibly claim damages to be placed in the position he or she would have been in had the contract been performed properly), or to cancel the contract and claim restitution or *restitutio in integrum* (damages to restore both parties to the positions	Normal contractual remedies apply in the event of any material breach.

	may order that this person give back the benefit or pay compensation. The aggrieved party must prove that the money was paid or property delivered; that there was no obligation to make payment or delivery; that payment or delivery was made in the mistaken belief that it was necessary; and that the mistake was reasonable.	they were in before entering into the contract).	

PRACTICALLY

SPEAKING

A typical contract will contain standard components

1 **Identity of parties**

- Names of parties.
- Type of entity of each party. For example, company, close corporation, or adult natural person.
- Physical addresses of the parties.

2 **Recitals**

- Background of agreement.
- Purpose of entering into the contract.
- Key assumptions of the contract.

3 **Obligations of the parties**

- What is each side required to do?
- By what date?
- If something is to be delivered, whose obligation is it and at whose cost? Is it insured? When will risk pass?

4 **Term of the contract**

- Will the contact be for a single event only or will it last for a designated time period?
- How can the term be extended or renewed?
- Is there a necessary date for performance?

5 **Price**

- What is the price for the product or service?
- Is it a fixed price, determined by a formula, by a project fee, or some other way?
- Who pays any tax or commissions?

6 **Payment terms**

- When is payment due?
- How must payment be made?
- Will there be instalment payments?
- Will interest be charged?
- Is there a penalty for late payment?

7 **Representations and warranties**

- What representations and warranties are to be made by the parties?
- Are certain warranties disclaimed? For example, *voetstoots* sale?
- How long do any warranties last for?

8 **Liability**

- What limitations of liability exist? For example, liability for consequential damage, or lost profits?
- Under what circumstances will a party be liable? For example, if there is a material breach of the agreements, or gross negligence?

9 **Termination of contract**

- When can one party terminate the contract early?
- What are the consequences of termination?

10 **Boilerplate clauses**

- Addresses for service of notices.
- Consent to jurisdiction.
- How amendments can be made to the agreement.
- Consent to arbitration.
- Whether or not assignment will be allowed.
- How the legal costs will be shared.

THIS CHAPTER IN ESSENCE

1. A contract may be defined as a lawful agreement made by two or more persons within the limits of their contractual capacity, with the serious intention of creating a legal obligation, communicating that intention without vagueness to each other, and being of the same mind as to the subject matter, to perform positive or negative acts which are possible of performance.
2. The general rule is that no formalities are required. Valid contracts can be made orally, in written form, or even by conduct. As long as the intention of the parties is communicated clearly, then an oral contract is generally as valid as a written one.
3. A void contract has a fatal flaw and has no legal existence at all; a voidable contract has a flaw that entitles the aggrieved party to choose whether to treat it as valid or not.

QUESTIONS

Short questions (1–5 marks)

1. Define a contract.
2. Provide four examples of formalities of contracts.
3. Give an example of a void contract.
4. Give an example of a voidable contract.

Paragraph questions (5 marks)

1. Write five points on formalities of contract.
2. What does it mean to put a contract ‘in writing’?
3. Compare what is meant by essential terms, terms arising by operation of law, and additional terms of a contract.

Essay question (10 marks)

1. Distinguish between void and voidable contracts.

Problem question (20 marks)

1. Sipho and Julius enjoy their nights at the pub so much they tell the barman they want to buy the place. The barman says, ‘Sharp! I will sell it to you for R10 000 cash, right now.’ Sipho and Julius decide to go 50:50, but Julius does not have enough money. Sipho goes to the bank and withdraws R10 000, and agrees that Julius can pay him the next month. Sipho gives the money to the barman who promises to give them the keys for the pub the next day. When Sipho and Julius arrive the next day, the pub is shut and the barman has left forever with all the money. Advise Sipho and Julius.

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1 Fouché, 33–35.

2 *Pieters and Company v Salomon* 1911 AD 121.

3 Gibson, 10.

4 *Goldblatt v Freemantle* 1920 AD 123.

5 Fouché, 37–38; Gibson, 58–62; Havenga et al., 83–84; Sharrock, 87–88; Swanepoel et al., 52.

6 *Wilken v Kohler* 1913 AD 135.

7 *Goldblatt v Freemantle* 1920 AD 123.

8 Sharrock, 167–168.

9 *Shoprite Checkers (Pty) Ltd v Bumpers Schwarmas CC and others* 2002 (6) SA 202 (C).

10 *Magwaza v Heenan* 1979 (2) SA 1019 (A).

11 *Goldblatt v Freemantle* 1920 AD 123.

12 Alienation of Land Act 68 of 1981.

13 *Just Names Properties 11 CC and another v Fourie and others* 2008 (1) SA 343 (SCA).

14 Alienation of Land Act 68 of 1981.

15 Sale and Service Matters Act 25 of 1964.

16 Housing Consumer Protection Measures Act 95 of 1998.

17 Deeds Registries Act 47 of 1937.

18 National Credit Act 34 of 2005.

19 General Law Amendment Act 50 of 1956.

20 Sharrock, 165.

21 Fouché, 38–39; Gibson, 9–10, 65–67; Sharrock, 3.

Chapter 7

Lawfulness of contract

'The law is reason, free from passion.'

ARISTOTLE (384 BC–322 BC)
GREEK PHILOSOPHER

What is covered in this chapter

1 Lawfulness

2 Statute

3 Common law

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

No matter what it is that people agree upon, a contract must be lawful in order for it to be valid and enforceable. A contract to commit a crime, or to achieve an illegal aim, can never be enforced by a court.

This chapter covers the first element of the definition of contract – lawfulness.

1 Lawfulness

As a general rule, all agreements are lawful unless they are prohibited by law. The prohibition can either be by statute or by common law.

An agreement is prohibited by common law if it is against public policy or against good morals. An unlawful agreement is void.[1]

2 Statute

A contract that is ‘prohibited by statute’ is an agreement that is against the law. For example, because employment of minors under the age of 15 years is prohibited by the Basic Conditions of Employment Act,[2] an employment contract with a ten-year-old child is against the law.

Statutory prohibition does not always make a contract void.[3] The court will examine the facts of each case to decide if it was the intention of the legislature to make that type of agreement void. The court will consider whether the statute provides adequate criminal penalties; whether recognition of the transaction would give some form of approval to the activity the legislature wanted to prevent; and whether greater hardship would result from deciding that the agreement was void instead of deciding it was valid and enforceable.[4]

Examples of contracts which may be void for reason of contravention of a statute include those that are against provisions of the Competition Act[5] or the Alienation of Land Act.[6]

3 Common law

If an agreement is against ‘public policy’ or ‘good morals’ this means that the court believes that enforcing the contract would go against the morality of our society.[7] Such a contract is also known as being *contra bonos mores*.

The concept of public policy is largely undefined. Courts must decide on each set of facts what are the acceptable social values of the time. These values are based on the fundamental constitutional values of human dignity, equality, and the advancement of human rights and freedoms.[8] A court will not declare an agreement to be against public policy unless it is openly and obviously harmful to the interests of the community.[9]

The following examples of contracts would be against public policy and would not be enforced by the courts:

- An agreement to threaten the safety of the State.
- An agreement unreasonably restraining the freedom to marry or divorce.
- An agreement to defraud the public, or for a public official to use his or her influence corruptly to obtain a benefit for another person.
- An agreement for an immoral purpose, for example to sell a human being.
- An agreement to undermine order, or that interferes with the administration of justice or the functioning of the courts, for example to commit a crime or a delict.

Bafana Finance, Mabopane v Makwakwa and another [10]

A money-lending contract provided that the debtor would not apply for an administration order in terms of the Magistrates' Courts Act.[11]

The court held that the clause was contrary to public policy and thus unenforceable. Public policy was anchored in the founding constitutional values which included human dignity, the achievement of equality and the advancement of human rights and freedoms. In this case the clause would deprive the debtor of his right to approach the court for redress from his difficult financial position. To deprive or restrict anyone's right to seek redress to court was offensive to one's sense of justice and against the public interest.

In some cases our courts have held that an agreement can be void for being against public policy if it is ‘unconscionable’. This means that it would not

be void just because the terms were harsh or unfair to one of the parties; to be void the court must find that the terms are so unfair, harsh or oppressive that no one can argue that the agreement was consistent with the morality of our society. For example, an agreement to cede all one's salary to a creditor for an unlimited time until the creditor decided otherwise was considered to be unconscionable because it deprived the debtor of his income and means of supporting his family, potentially forever.[12]

PRACTICALLY

SPEAKING

What does it mean to outsource a part of your business?

Some people think of outsourcing as synonymous with retrenchments: sometimes a business finds it is cheaper to make something overseas than it is in South Africa because our costs of labour are so high compared to other countries. However, outsourcing is something to think about when it comes to providing sophisticated functions in your business at a reasonable price. As a small business you can use out sourcing to grow your business without having to employ experts and highly skilled employees, who can be very high salary earners.

Some of the functions that can be outsourced by new businesses include:

- **Accounting**: As a new businessperson it is more important for you to do what you are good at and to spend your time growing the business, than to allocate a lot of time dealing with accounts and bookkeeping, input credits and tax statements. Be smart – hire a bookkeeper to do your accounts and spend the time getting new customers, improving relations with your suppliers, and growing your business.
- **Communications**: When customers telephone a business they want to be able to speak to a real person on the line, 24 hours a day, seven days a week. Some people do not like recorded messages; as a new business you should try to provide excellent service to your customers, or else they may support one of your competitors.

  If you are not able to deal directly with your customers on the phone, you may want to consider outsourcing this function. A call centre will be available at all hours of the day and night, and can answer your number using your business name. They can also deal with all requests for information and send the messages on to you to deal with personally. It may be cheaper and more efficient to hire a call centre to do this for you than to employ employees.
- **IT and computers**: Computer technology can be very expensive; not only to buy the equipment but also to pay for software and the necessary licences. In addition, there are costs of maintenance and sorting out inevitable problems. The real value of outsourcing your IT function is that you will not be responsible for any of the maintenance, insurance and repairs, and you can get the newest and best equipment and software to help run your business.
- **Sales**: You may have a brilliant idea for a new business but might lack the sales skills necessary to convince customers to switch from their existing suppliers and to try your goods or services. It is possible to outsource your sales function so that another business is responsible for the marketing and sales of your new business. You will need to plan how this could work in detail, because you are in effect trusting the future of your business to another. One alternative is to engage contractors to do this for you, or to start with a small part of the sales function first, before putting all your eggs into one basket.
- **Operations**: If a large part of your product or service is similar to what others are supplying, it may be worthwhile to outsource that component or part of your business to another. Often, a bigger more established business can do standard things cheaper and more quickly than you could, so it might pay you to get the component done

elsewhere, and then simply add value before supplying your customer with the finished goods or services.

THIS CHAPTER IN ESSENCE

1. As a general rule, all agreements are lawful unless they are prohibited by law. The prohibition can either be by statute or by common law.
2. Statutory prohibition does not always make a contract void. The court will examine the facts of each case to decide if it was the intention of the legislature to make that type of agreement void.
3. If an agreement is against ‘public policy’ or ‘good morals’ this means that the court believes that enforcing the contract would go against the morality of our society. In some cases our courts have held that an agreement can be void for being against public policy if it is ‘unconscionable’.

QUESTIONS

Short questions (1–5 marks)

1. What is the effect of an unlawful contract?
2. List four examples of contracts that are against public policy.

Paragraph questions (5 marks)

1. What does it mean if a contract is ‘against public policy’?
2. What is the effect of an illegal contract?

Problem questions (20 marks)

1. Dopehead grows dagga in his backyard. He sells some dagga to Meathead for R400. Meathead takes immediate delivery and promises to pay the purchase price at the end of the month. Meathead fails to pay. In terms of legislation it is illegal to possess dagga or to sell it to anyone. Discuss Dopehead's legal position.
2. Yusel is a shop retailer. He does not have a trading licence and buys goods from Sandy, a wholesaler. After six months, Yusel owes Sandy R200 000 and refuses to pay, saying that the sales were all illegal and that he is therefore not bound to pay. Advise Sandy.

3. Winnie, a married woman, promises Sydney, a single man, that if he gives her R50 000, she will divorce her husband and marry him. Sydney believes Winnie and gives her the money. Winnie later refuses to divorce her husband and also refuses to return the money. Advise Sydney.

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1 Fouché, 38; Gibson, 10–17; Havenga et al., 75; Sharrock, 94–97; Swanepoel et al., 47–52.

2 Basic Conditions of Employment Act 75 of 1997.

3 Havenga et al.,79; Sharrock, 92–94; Swanepoel et al., 48.

4 *Pottie v Kotze* 1954 (3) 719 (A); *Metro Western Cape (Pty) Ltd v Ross* 1986 (3) SA 181 (A); *ABSA Insurance Brokers (Pty) Ltd v Luttig and another NNO* 1997 (4) SA 229 (SCA).

5 Competition Act 89 of 1998.

6 Alienation of Land Act 68 of 1981.

7 Swanepoel et al., 48.

8 *Brisley v Drotsky* 2002 (4) SA 1 (SCA).

9 Sharrock, 94–95.

10 *Bafana Finance, Mabopane v Makwakwa and another* 2006 (4) SA 580 (SCA).

11 Magistrates' Courts Act 32 of 1944.

12 *Sasfin (Pty) Ltd v Beukes* 1989 (1) SA 1 (A).

Chapter 8

Capacity to contract

'He who is his own lawyer has a fool for a client.'

PROVERB

What is covered in this chapter

1 What is capacity?

2 Factors affecting capacity

3 Minority and the contractual capacity of minors

4 The ability of minors to enter into valid contracts

5 Liability of minors on assisted contracts

6 Liability of minors on unassisted contracts

7 Statutory protection for persons lacking legal capacity

8 Marriage and the contractual capacity of married women

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the second element in the definition of contract – the capacity to contract.

Not everyone in our society is allowed to have the same ability to enter into contracts or to enforce them. For example, minors may have fewer rights than do adults, and human beings may have different rights than companies may have.

When entering into a contract it is important for us to know the rights and duties that each side will have – this is affected by their contractual capacity. If we know that the other party to an agreement has limited capacity or no capacity to enter into the contract, we need to know how to protect our interests in the contract being performed.

1 What is capacity?

Capacity refers to competence in the eyes of the law to:

- Have rights and duties.
- Perform juristic acts.
- Incur civil or criminal liability for wrongdoing.
- Be a party to litigation, that is, to sue or be sued in one's own name. The capacity to litigate is called ‘legal standing’.

As a general principle, any juristic or natural person has complete and unrestricted control over his or her affairs and has full contractual capacity.[1]

2 Factors affecting capacity

We will look at factors affecting the capacity of juristic persons and natural persons.

2.1 Capacity of juristic persons

Juristic persons will either have full, limited or no capacity to contract:

- **Self-imposed limitations**: A juristic person such as a company may have its capacity to contract limited by its Memorandum of Incorporation, as well as by resolutions of those with authority to bind it, such as shareholders or directors. As a general rule, any agreement made by a company, other than something which is against the Companies Act, is not void just because the company did not have the capacity to act that way. The lack of capacity or authority can, however, only be used as a defence if the company or its directors are sued by shareholders.

  Shareholders may by special resolution ratify an act previously done by the company which was outside of the authority it had in its Memorandum of Incorporation.
- **Business rescue proceedings**: A company's own management may try to rehabilitate a company that is unable to pay its debts or that is soon to become insolvent. The process of rehabilitation is called ‘business rescue proceedings’. It results in the appointment of a temporary business rescue practitioner over the management of the company. Generally, no legal action can be started or continued without the written permission of the business rescue practitioner.

  During business rescue proceedings, a guarantee or suretyship of a company cannot be enforced unless a court grants special permission. The court can also impose any terms it considers suitable. Employees continue to remain in employment. The company may unilaterally cancel or suspend, partially or conditionally, any provision of any contract (except a contract of employment). An aggrieved party to a contract that has been suspended or cancelled can only claim damages.

- **Insolvency**: Once a company has been liquidated by a High Court and all its assets and liabilities are vested in an insolvent estate controlled by a trustee, it no longer has the capacity to enter into any contracts. All contracts previously entered into by the insolvent company remain valid unless cancelled by the trustee.

Table 8.1 *Factors affecting the contractual capacity of a company*

No capacity	Limited capacity	Full capacity
• Unregistered.	• Self imposed formalities may be contained in the company's Memorandum of Incorporation. • Business rescue proceedings limit the capacity of directors, who require the assistance of a business rescue practitioner.	• Registered. • Comply with formalities.

2.2 Capacity of natural persons

Natural persons will either have full, limited or no capacity to contract:[2]

- **Minority**: A natural person under the age of 18 years is called a ‘child’.[3] An unmarried child is called a ‘minor’.

  A minor has no contractual capacity if aged under seven years because he or she has no understanding and no judgement. One of the minor's guardians must enter into contracts on behalf of such a minor. A minor aged less than seven years also has no capacity to sue. Where legal action must be taken to protect the minor's interests, one of the minor's guardians must represent the minor.

  A minor who is unmarried and aged seven years and older, but under 18 years, has only limited contractual capacity. He or she has understanding but no judgement. The guardian may provide assistance to a minor aged between seven and 18 to enter into contracts. Where legal action should be taken to protect such a minor's interests, the minor's limited capacity is supplemented by a guardian, who will assist the minor.

  Once a natural person turns 18 years of age, he or she reaches the age of majority and is called a ‘major’ or an ‘adult,’ and has full contractual capacity and legal standing. Similarly, once a child gets married they acquire full contractual capacity and legal standing.

However, because marriage is a contract, a child who wants to get married still requires permission from his or her guardians to do so. Once validly married, even if the marriage is terminated for any reason, the child will continue to keep full contractual capacity and legal standing.

- **Marriage**: Under the previous matrimonial property laws, many married women were subject to the marital power of the husband. This meant that they could not enter into contracts without the permission of their husbands. A woman married under this system was in a similar legal position to a minor.

  Marital power was abolished in our legal system during 1993, with retrospective effect. The Matrimonial Property Act[4] now stipulates that married women have similar contractual capacities to those of married men.

- **Mental illness**: All persons are presumed sane unless declared mentally disordered or mentally ill by the High Court in terms of the Mental Disorders Act[5] or the Mental Health Act.[6]

  Once a person has been declared mentally unsound, any contract entered into will be void if that person could not appreciate and understand the nature of the contract.[7] It will also be void if his or her intention to enter into the contract was influenced by an insane delusion.[8]

  However, if the person was thinking clearly at the time the contract was entered into, it will be valid and enforceable.[9] This is known as having a ‘lucid moment’. Even when his or her thinking was not lucid, he or she may incur an obligation on the grounds of unjustified enrichment.

***Prinsloo's Curators Bonis v Crafford and Prinsloo*[10]**

A man was declared by the court to be of unsound mind. After this, during a moment when he understood the nature and significance of his conduct, he married in community of property. The court held that the marriage was valid.

- **Intoxication**: The contract will only be void if the person was so intoxicated that he or she had no idea of the terms of the contract or did not know he or she was even entering into a contract.[11] Despite the

contract being void, the person may still incur an obligation on the grounds of unjustified enrichment.

- **Prodigality**: A prodigal (spendthrift) is a person who, through a defect of character or will, squanders his or her assets with such abandon that it threatens to reduce that person or his or her dependants to destitution. An interested party may apply to the High Court to appoint a curator for the prodigal, though the court is normally reluctant to do so as this would amount to significant interference with that person's rights. Once appointed, the curator will administer the prodigal's property affairs and may contract on his or her behalf. As with a minor, unassisted contracts may be ratified by the curator. The prodigal will retain full contractual capacity in respect of matters falling outside his or her property interests.
- **Insolvency**: After the High Court declares a person to be insolvent, his or her estate is controlled by a trustee. Certain restraints are placed on the insolvent's contractual capacity. He or she may not dispose of any property falling into the insolvent estate and may not enter into any contract to the prejudice of the estate. The insolvent may not have an interest in a general dealership or manufacturing business, nor may he or she be a director of a company. All contracts entered into by an insolvent remain valid until cancelled by the trustee.[12] Insolvency is dealt with in greater detail in another chapter of this book.
- **Criminal conviction**: If convicted by a court of certain crimes involving dishonesty, a person generally may not be appointed as a director of a company.
- **Alien enemy**: All contracts entered into with any person living or carrying on business in enemy territory are prohibited.

As a general rule, any agreement affected by one of the above factors is beyond the contractual capacity of the party and is therefore void.

3 Minority and the contractual capacity of minors

A ‘child’ is a natural person under the age of 18 years. A child who is unmarried is called a ‘minor’. The law distinguishes between the contractual capacity of minors aged under seven years, and minors aged between seven and 18 years. (Note that the capacity of minors to commit a wrong is different to the capacity of minors to incur a contractual obligation, and is also covered in the web-based text in chapter 37 on the law of delict.)

A minor under the age of seven years is regarded by the law as having an insufficient level of development to enable him or her to form a sound judgment of any contractual obligation. He or she has absolutely no capacity to enter into any contract and, similarly, cannot accept any donation. Such a minor requires a guardian to ‘represent’ him or her by entering into certain contracts on behalf of the minor regarding his or her maintenance and estate. If any contract entered into on behalf of the minor proves to be prejudicial to him or her at the time it was entered into, the minor, within one year after attaining majority, may apply to the High Court to cancel the contract and obtain restitution of his or her entire performance.

A minor aged between seven years and 18 years is deemed by the law to possess an independent will, but lacks maturity of judgement. Such a minor has limited contractual capacity and requires a guardian to ‘assist’ him or her to supplement this limited capacity or assist the minor to enter into any contract. A minor also requires the assistance of the guardian in court.[13] The purpose is not to punish the minor, but to protect the minor from his or her own immature judgement.

One of the responsibilities and rights of a parent is to act as a guardian of the child. A guardian must administer and safeguard the child's property interests; assist or represent the child in administrative, contractual and legal matters. Where the parents are married to each other, they are both guardians of the minor. Each one of them may in their own right act as a guardian, and is able to exercise independently any right or responsibility arising from their guardianship.[14] Acts that require the consent of both

parents as guardians include granting consent to the child's marriage, civil partnership, adoption, departure or removal from South Africa, application for a passport, or the sale or mortgage of any immovable property or right to property that belongs to the child.[15]

Where a child is born outside of marriage or civil partnership, the mother is the sole guardian unless she herself is a minor, in which case her guardian will also be the guardian of the child. The guardians of an adopted child are the adoptive parents.[16] If there is no satisfactory guardian, a legal guardian may be appointed by the High Court, which is the self-appointed 'upper guardian' of all minors.[17]

Minority terminates automatically when the minor turns 18 years of age. This is known as attaining 'majority'. A minor who enters into a valid marriage or civil partnership is deemed to acquire the status of a major, and automatically obtains full contractual capacity and legal standing. Such capacity and standing remain, even if the marriage or civil partnership is later terminated before he or she turns 18.

Normally, all contracts entered into by unassisted minors are void, even if they are to the advantage of the minor.

Edelstein v Edelstein NO[18]

The court set aside an antenuptial contract that had been entered into by a minor prior to her marriage. Even though the guardian had agreed to the contract of marriage, he had not given permission to the minor to enter into the antenuptial contract.

4 The ability of minors to enter into valid contracts

It is possible under certain circumstances for minors aged between seven years and 18 years to enter into valid contracts:[19]

- **With the assistance of a guardian**: The minor will be bound by contracts made on his or her behalf by one of his or her guardians or by contracts made by himself or herself with the assistance of a guardian.[20]

  The guardian does not have to know the specific terms of the agreement, he just has to know the type of agreement being entered into.

> ***Van Dyk v South African Railways and Harbours*** [21]
>
> A minor entered into an employment agreement with the SAR and H in terms of which he could not resign for three years. He was not assisted by his father at the time the contract was made, his father was not present when it was signed, and didn't know the precise terms. However, the father had signed a document granting permission for his son to be employed by the SAR and H.
>
> The court held that the consent was sufficient to prove assistance and that the contract was binding on the minor.

On achieving majority, the minor may repudiate liability under a contract that was prejudicial and that has caused him or her loss. The contract may have been entered into by a guardian on behalf of the minor or by the minor with a guardian's assistance. To escape from the contract, the minor must show that the guardian consented or acted in a way that no reasonable person would have done.[22]

The minor must then restore to the other party the extent of the benefit that he or she received under the contract and has in his or her possession and control at the time of the court action. The prejudice must be proved to be substantial and not trivial.[23]

> ***Wood v Davies*** [24]
>
> The court set aside a contract for the purchase of a house that had been entered into by the guardian on behalf of the minor where it was shown that the price was excessive, the purchase unnecessary, and there were harsh clauses which imposed obligations on the minor which would last after he became a major.

- **Married persons or civil partners under 18 years of age**: Marriage or civil partnership is a contract like any other. Minors who marry or become civil partners automatically acquire full contractual capacity and legal standing. However, the decision by a minor to enter into a marriage or civil partnership must have the consent of both of the child's guardians. Any marriage or civil partnership entered into without the consent of both guardians will be void.[25] In addition, in the case of a female who is under 15 years of age or of a male under 18 years of age, the consent of the Minister of Home Affairs is necessary to get married or enter into a civil partnership.[26]

  In terms of the Recognition of Customary Marriage Act,[27] a customary marriage entered into after 15 November 2000 in which a spouse is not a partner in any other existing customary marriage is deemed to be a valid marriage in community of property, and the spouse is a major. The status of a spouse in a customary marriage entered into before that date is still governed by customary law.

  In terms of the Civil Union Act,[28] same-sex partners may enter into a civil partnership with the same legal consequences as a marriage performed under the Marriage Act.[29] A person may only be a spouse or a partner in one marriage or civil partnership, as the case may be, at any given time.
- **Emancipation**: The law accepts that minors may work for a living. It is therefore difficult to justify to a minor who works for his or her own living why he or she is unable to enter into contracts on his or her own behalf.

  A guardian may allow the minor to control his or her own trade, business, or professional affairs. Permission may be granted to a lesser or greater extent. This type of permission is known as ‘emancipation’. Where the permission is implied it is known as ‘tacit emancipation’. Separate residence and financial independence are factors considered by the court in deciding whether or not the guardian has given such permission.[30]

  Dickens v Daly [31]

  A minor was sued on a cheque that he had drawn but that was later dishonoured. The minor raised his minority as a defence; the plaintiff alleged that the minor was

tacitly emancipated. He had been living with his mother and stepfather for the past 12 years, contributing an amount for board and lodging; he had been employed as a bank clerk for four years; he had operated a bank account unassisted. His father lived in another province and did not exercise any control over him.

The court held that the minor had been tacitly emancipated.

An emancipated minor may validly contract within the limits of the emancipation. However, he or she may not contract outside these limits without a guardian's consent. The extent of emancipation is a question of fact to be decided by the court on the circumstances of each case.[32]

If a guardian allows the minor to enter into contracts relating only to the minor's business or occupation, then the minor's capacity is limited to acts related to the business or occupation.[33]

Ahmed v Coovadia [34]

To avoid creditors, a father opened a bank account in his minor son's name, and the son wrote a letter authorising the father to operate the account. The son worked away from home and sent all wages to his father, and asked the father for whatever money he needed. The father controlled the account entirely, and the son never wrote any cheques himself. Some cheques were dishonoured and the son was sued on the basis that he was tacitly emancipated.

The court held that even assuming the son was emancipated in respect of his employment, he was not emancipated regarding the debts from the bank account.

If a guardian consents to complete freedom regarding the minor's lifestyle in the form of a general authority, then the minor will have full capacity in most circumstances. However, even general authority does not terminate minority and the minor will still require the guardian's consent for any contract falling outside that general authority. For example, marriage or sale of property.

The guardian must actually have given some kind of consent for the emancipation. Simply establishing that a guardian shows no interest in the minor does not prove that the minor had been released from the guardian's authority.

Dama v Bera [35]

A minor lived with her parents, but paid for board and lodging. She sued her employer for outstanding wages. His defence was that she lacked capacity to sue in her own name.

The court held she was tacitly emancipated and was allowed to sue her employer for outstanding wages without the assistance of her guardian.

Grand Prix Motors WP (Pty) Ltd v Swart [36]

An unassisted minor who bought a motor vehicle sued the dealer for the return of the purchase price. The dealer claimed the minor was emancipated because her parents were divorced and the father had disappeared seven years earlier.

The court held that since the mother had obtained custody and not guardianship during the divorce, the father remained guardian. Just because he had disappeared it could not be assumed he had emancipated the daughter.

- **Ratification**: Any contract entered into by a minor without the guardian's consent can be confirmed by the guardian or by the minor himself or herself on reaching majority. This is known as ‘ratification’ and may be express or implied. Once ratified the contract is valid as from the date of the agreement.[37]

Stuttaford and Co v Oberholzer [38]

A minor bought a motorbike on instalments. The contract was entered into without his guardian's assistance. He continued using the bike after the birthday he became a major. Payments fell into arrears, and he was sued by the seller for the balance owed. He alleged that as the contract had been entered into while a minor, he was not liable, and claimed repayment of the instalments he had paid under the contract.

The court held he had ratified the contract by his conduct in continuing to use the motorbike, and that he was bound by the contract.

- **Statutory exceptions**: Various Acts of Parliament provide that minors of a certain age may enter into certain types of contracts without any assistance from their guardians:[39]
  - The Children's Act[40] provides that a child over the age of 12 may consent to his or her own medical treatment, if he or she is of sufficient maturity and has the mental capacity to understand the benefits, risks, social and other implications of the treatment. Also, no person may refuse to sell condoms to a child over the age of 12 years, or refuse to provide such a child with condoms on request from any place where condoms are normally provided free of charge. Other types of contraceptives may be provided without the consent of the parent or caregiver if the child is at least 12

and subject to proper medical advice being given to the child and a medical examination carried out on the child.

- The Choice on Termination of Pregnancy Act[41] provides that a female minor, irrespective of age, does not require the consent of her parents for the termination of a pregnancy.
- The National Road Traffic Act[42] provides that a person who is 17 years or older may obtain or hold a learner's driving licence.
- The Post Office Act[43] allows a minor over seven years of age to withdraw monies deposited in his or her account.
- In terms of the Wills Act[44] a minor of 16 years may make a valid will.
- A minor of 16 years or older may consent to the donation of his or her body or tissue for educational, scientific, or research purposes.

Table 8.2 *Factors affecting contractual capacity of minors*

No capacity	Limited capacity	Full capacity
• Minority: child aged under seven years. • Intoxication: to the extent that the person had no idea they were entering into a contract at all.	• Minority: child aged seven and older. Requires the consent of a guardian to supplement the limited capacity. • Minority: tacitly emancipated minor may contract without a guardian's assistance within the limit of his or her emancipation.	• Majority: aged 18 years and older. • Marriage: a minor aged under 18 who enters into a valid marriage is deemed to have full contractual capacity.

5 Liability of minors on assisted contracts

Where the minor is assisted by a guardian in entering into a contract, the minor is bound to the terms of the agreement, which is valid and binding. In the absence of fraud, the guardian is not liable to the minor even when the contract is inherently a bad deal, or has terms and conditions that are prejudicial to the minor.

Where the assisted contract is prejudicial, the minor may go to court to have it cancelled. This is known as having the contract ‘set aside’. An action to set aside an assisted contract must be brought with the assistance of the guardian, or within a reasonable time after the minor turns 18 years of age.

In addition to asking the court to set the contract aside, the minor may ask for ‘restitution to the pre-contractual position’ or *restitutio in integrum.* This means that the other party must give back to the minor everything that the minor has paid or given in terms of the contract. This ‘restores’ the full extent of the minor's performance. The court will also order the minor to give back to the other party the extent of the minor's enrichment at the time of the court action, or to pay the other party an amount of money to the value of the benefit received. The effect is to place the minor in the position he or she was in before the contract was entered into. In legal terms, the minor is restored to his or her pre-contractual position.

6 Liability of minors on unassisted contracts

6.1 An innocent minor

Where an innocent minor enters into a contract on his or her own, without a guardian's consent, the contract is void. The minor cannot be held liable under the terms of the contract and is entitled to the return of any money or property given in terms of the contract.[45] The minor, however, may incur an obligation if he or she has been enriched or has received a benefit at the expense of another.

Tanne v Foggit [46]

A minor entered into an unassisted contract with the owner of a typing college to take lessons, the fee payable in advance. Termination of the contract required one month's notice be given. The minor paid the fee for one month and attended for that month, but then stopped attending without giving notice. The minor was then sued for one month's fees.

The court held that the contract was unassisted, and that the minor was not liable on the contract.

If the minor wishes to hold the other party to the contract, he or she may sue the other party with the assistance of a guardian, or by himself or herself on the attainment of majority at age 18. In this way, the minor can choose whether to enforce the contract or to cancel it. The other party is denied this choice and must abide by the decision of the minor. This is known as a 'limping' contract because of the unequal situation.[47]

On being sued, the other party must restore the minor to the position in which the minor was before the minor contracted. This is known as restitution or *restitutio in integrum*. The minor must restore to the other person the extent of the minor's enrichment at the time of the court action or pay the other party a sum of money to the value of the benefit received.

If the minor wants to get out of such a contract and has lost the benefit, the law would seem to have a problem. Should the minor get back his or her performance from the other party without returning the benefit received? On the other hand, why should an adult be allowed to deceive or take unfair

advantage of an innocent minor? The law is clear that minors must be protected. Accordingly, the minor may reclaim his or her performance. If there is no benefit left, then that is to the disadvantage of the contracting party. Majors should always be careful of contracting with minors.

For example, if an unassisted minor buys a motorbike and then wishes to get out of the contract, the minor will get back all the money paid and must return the motorbike. If the motorbike was stolen or destroyed, the minor will not have to give back anything. He or she will still get all the money back. If the minor received a benefit from using the motorbike, he or she may be liable to the other party, but only to the extent of the benefit received.[48]

6.2 A fraudulent minor

Where the minor pretends to have capacity, says he or she is emancipated, or says he or she has the consent of a guardian, and the other party believes the minor and contracts with the fraudulent minor, the contract is void because of the minor's lack of capacity. Unlike the case of an innocent minor, the fraudulent minor is not entitled to restitution to the pre-contractual position.[49]

Special rules apply to the fraudulent minor. As with all minors, he or she is liable to the extent of the enrichment, but because of the fraud he or she has an additional liability.

There are four theories of additional liability that could possibly apply to the fraudulent minor:

- **The minor should be held liable on the contract**: This is obvious nonsense. The contract can never be binding. This would give the fraudulent minor greater capacity than he or she ever could have legally, even if he or she were an innocent minor.
- **The minor should be held liable on the basis of estoppel**: This means the other party should not allow the minor to claim minority as a defence to any claim. In terms of the ‘doctrine of estoppel’, a person is prevented from denying the truth of a representation previously made by him or her (intentionally or negligently) to another person if that person, believing it to be true, acted on this representation to their prejudice. The

result of this would be that the minor would be held to an unenforceable contract.

- **The minor should be held liable only for delictual damages**: This approach is problematic because the claim for damages could be less, or more, than the contract value.
- **The minor should not be held liable on the contract, but is prevented from obtaining restitution to the pre-contractual position**: This is the approach followed by our law. It means that a fraudulent minor can never reclaim what he or she has already given under the contract, but the other party is able to reclaim the enrichment gained by the minor. This is the penalty a fraudulent minor must pay for dishonesty.[50]

7 Statutory protection for persons lacking legal capacity

If a person lacking full legal capacity enters into a transaction covered by the Consumer Protection Act,[51] then the agreement will be void if it was entered into by a consumer whom a court has declared mentally unfit.

The agreement will be voidable if the consumer was an unemancipated minor, or the agreement was made without a guardian's consent, or it was not ratified. If, however, the consumer or someone acting on his or her behalf attempted to induce the supplier to believe that the consumer had full legal capacity, then the Act will not apply, and remedies will be decided in terms of the common law.

8 Marriage and the contractual capacity of married women

Under common law, all spouses married prior to 1 November 1984 (unless they signed an agreement before the marriage called an antenuptial contract) were automatically married in ‘community of property’; in ‘community of profit and loss’; and with the ‘marital power’ vesting in the husband.[52]

In effect, the wife's contractual capacity was similar to that of a minor. She had no power to enter into any contract to bind herself or her husband without the consent of her husband. Her husband could ratify her unassisted contracts.[53]

8.1 Community of property

Everything owned by the spouses prior to the marriage was pooled in a joint estate, which was owned by the spouses in equal undivided shares.

8.2 Community of profit and loss

All profits and losses incurred during the marriage affected the joint estate. On termination or dissolution of the marriage, the profit or loss of the joint estate was divided equally between the spouses.

8.3 Marital power

The husband was automatically the sole administrator of the joint estate and was the only person with the capacity to bind the joint estate. This meant that the wife was virtually in the position of a minor and required the consent of her husband to ratify contracts in order to bind the joint estate. However, there were some exceptions:

- **Household necessities**: A wife could freely contract for life's necessities, which included food, medical and dental expenses, and clothing, but only according to the standard of living of the spouses and not necessarily according to their income.[54]

- **Public trader**: If a wife was a public trader, any contract entered into in the course and scope of her business was binding on the joint estate. Profits and losses that accrued to the joint estate were controlled by her husband, the administrator. The husband was deemed to have given his consent to her trading. However, his consent could be withdrawn at any time for any reason.[55]
- **Statutory exceptions**: If a wife entered into any contract that resulted in the joint estate being enriched, the joint estate would be liable to the extent of that enrichment. A wife also could own certain insurance policies and operate her own bank account, provided she did not overdraw the account without the consent of her husband.

8.4 Matrimonial Property Act

The situation was changed for marriages entered into on or after 1 November 1984 by the introduction of the Matrimonial Property Act.[56]

Under the Act, marital power is automatically excluded and women have the same contractual capacity as men. Marriages are automatically deemed to be in community of property and in community of profit and loss. The wife is a joint administrator of the joint estate. The spouses are considered to have equal rights and duties. Neither of the spouses may dispose of certain assets without the written consent of the other. If a spouse does so to the disadvantage of the other, the prejudiced spouse may be compensated if the marriage ends.

Consent can in some cases take place within a reasonable time after the act. Consent may not be required at all where the act is done in the ordinary course and scope of the spouse's profession, business, or trade.[57]

In 1993 marital power was abolished in terms of our law with retrospective effect. Marriages may now be entered into in one of two ways:

- In community of property.
- Out of community of property.

In 2006 the Civil Union Act[58] provided for two natural persons of the same sex to be able to enter into a civil partnership with the same legal consequences as a marriage entered into between persons of opposite sexes.

8.4.1 Marriage or civil partnerships in community of property

A marriage or civil partnership will automatically be in community of property, unless the parties enter into a properly executed and registered antenuptial contract before the marriage. The antenuptial contract must also specifically exclude community of property and community of profit and loss. The consequences of marriage or civil partnership in community of property are as follows:

- **Community of property**: All the assets and liabilities belonging to each party are combined into a single ‘joint estate’. The parties become co-owners of the joint estate immediately on marriage or civil partnership.
- **Administration of the joint estate**: Each spouse or civil partner has the capacity to incur certain rights and obligations in their own name, but generally must get the other's agreement before doing anything prejudicial to the joint estate.

  Formal consent is needed to sell or mortgage from the joint estate a real right to immoveable property, to enter into a credit agreement, or to bind themselves as a surety. Written consent is also needed to sell, cede or pledge any securities, fixed deposits, investments or moveable assets, or to withdraw any money held in an account. Informal consent is required to sell or pledge joint estate furniture or household items, or to receive money due to the other spouse from their remuneration, inheritance, damages, dividends or interest.

  Generally, a contract without consent will be void. However, consent will be deemed to have been given if the other party to the contract had no knowledge of the lack of consent and could not reasonably have known that consent was not given.

  If one party's dishonesty causes the joint estate a loss, then the court will adjust the other party's share of the joint estate when it is divided on the dissolution of the marriage or civil partnership.
- **Community of profit and loss**: All the property obtained and all the debts incurred by the spouses after they are married fall into the joint estate. This is owned by them equally, in undivided shares.

8.4.2 Marriage out of community of property

If spouses or civil partners sign an antenuptial agreement before marriage, they may choose to be married or become civil partners out of community of property. They both have full contractual capacity and are not liable for each other's debts. However, they are ‘jointly and severally liable’ to others for any debts each of them may incur for the joint household. This means that each spouse or civil partner is liable for their own debts, as well as for the debts of the other.

Under the Act, the parties may choose whether the marriage or civil partnership will be governed by the accrual:

- **Accrual system included**: A commencement value for the estate of each spouse or civil partner is agreed upon at the beginning of the marriage or civil partnership. At the end of the marriage or civil partnership, the commencement value is adjusted to take into account inflation. Also, a final value of each estate is calculated. The differences in growth for both estates is added together, and then shared equally between the parties. An inheritance, legacy or donation is excluded from calculating the accrual.[59] The accrual system applies only to the parties as between themselves. As far as their creditors are concerned, they will still be married out of community of property. Each spouse or civil partner remains owner of the assets they brought into the marriage or for debts they incurred during the marriage. Each spouse or civil partner is also separately liable for his or her debts that existed before the marriage. The right to the accrual arises only on the marriage ending by death, divorce or court order. This is known as ‘dissolution’.

  In the simplified example in Table 8.3 below, the wife's accrual is added to the husband's accrual, and then split 50/50 so that they each end up with their respective commencement values plus a half-share of R240 000. Inheritances are excluded from each accrual. In the example below, this means that the husband will leave with R500 000 (inheritance) + R60 000 (commencement value) + R120 000 (half-share of total accrual); the wife will leave with R40 000 (inheritance) + R30 000 (commencement value) + R120 000 (half-share of total accrual).

Table 8.3 *Division of accruals after dissolution of marriage*

	Husband	**Wife**
Commencement value of estate *(adjusted for inflation)*	R 60 000	R 30 000
Inheritance, legacy or donation *(not used for calculating growth of accrual)*	R500 000	R 40 000
Final value of estate	R100 000	R230 000
Accrual *(final value less commencement value, excluding inheritance)*	R 40 000	R200 000
Total accrual of both parties	**R240 000**	
On 50/50 split of the total accrual each party receives	**R120 000**	

- **Accrual system excluded**: Each spouse or civil partner keeps his or her property without any claim against the other if the marriage or civil partnership is dissolved. Each one keeps control over his or her own estate, and can take legal action without the consent of the other spouse. Each spouse or civil partner can enter into contracts without the consent of the other. Spouses or civil partners out of community of property are jointly and severally liable to third parties for all debts incurred by either of them for the household necessaries of the joint household.

8.5 Formalities required for an antenuptial contract

The antenuptial contract must be duly initialled and signed in duplicate original by both parties and two witnesses, and both guardians where assistance is needed. All the signatures must take place in front of a notary public. This is called ‘attestation’.

The antenuptial contract must be registered in the Deeds Office within three months of date of signature, failing which it may be registered late only by application for a court order.

8.6 Forfeiture of benefits

‘Forfeiture of benefits’ happens when a court finds one spouse or civil partner should lose the financial benefits of the marriage or civil partnership in favour of the other. A court can order forfeiture no matter how the

spouses have been married, or how the civil partners entered into the civil partnership.

Forfeiture can be either whole or in part. The court will consider the length of the marriage or civil partnership, the circumstances which gave rise to the breakdown and any substantial misconduct on the part of either of the parties.

Typically a court may order forfeiture where one party caused the dissolution by cheating on the other, or was violent to the other party.

8.7 Marriage equality

The concept of marriage has also undergone reform with the passing of the Civil Union Act.[60] In terms of this Act, two natural persons of the same sex may enter into a civil partnership with the same legal consequences as a marriage entered into between persons of opposite sexes. A person may only be a spouse or partner in one marriage or civil partnership, as the case may be, at any given time.

The rights recognised under this legislation are in accordance with the constitutional rights of people not to be discriminated against on the grounds of their sexual orientation.[61]

Under the provisions of this Act, reference to ‘marriage’ in the Matrimonial Property Act[62] and in the common law includes a civil union; similarly reference to a husband, wife, or spouse includes reference to a civil union partner. In effect this means that civil union partners can enter into valid antenuptial contracts on the same basis as husbands and wives.

PRACTICALLY

SPEAKING

Office alternatives for new businesses

When you start a new business you can decide many things: this includes when you will work, and from where.

Many people plan to work from home. However, this may provide some unexpected difficulties. Your local council may insist on your property being rezoned; other problems could include the noise of your business, and there can be many distractions at home especially if there are children around.

You may decide that you want a more professional image of your business than that which you can provide if you work from a residential house. Some of the alternatives that new businesses may want to consider include:

- **Serviced office**: To save on buying or renting your own furniture and office equipment, it is possible to rent a serviced office. You will be charged a weekly or monthly rate for the rental of a furnished office and for all the other administrative services and facilities that you may need, including telephone, internet, video facilities, reception, conference and meeting rooms, kitchen, secretary, and security. You pay for what you get, so you can choose to rent as much or as little as you may need, while maintaining a professional modern business appearance.
- **Occasional office**: For even more flexibility, you can pay a fee to use a fully equipped office for a certain number of days per month.
- **Virtual office**: As a small business you may want to create the appearance of a full office, but actually renting one. For a weekly or monthly fee you can rent a virtual office. You will be given a business address, and all post and telephone calls will be forwarded to your actual address and telephone number. If you need an office to meet people or to hold a meeting in a conference room, these can be rented as required.

THIS CHAPTER IN ESSENCE

1. Capacity refers to competence in the eyes of the law to have rights and duties; perform juristic acts; incur civil or criminal liability for wrongdoing; and be a party to litigation.
2. Generally, any juristic or natural person has complete and unrestricted control over his or her affairs and has full contractual capacity. However, various factors can affect the capacity of juristic persons and natural persons.
3. Natural persons under the age of 18 years, who are unmarried, are called minors.
4. A minor aged between seven years and 18 years has limited contractual capacity and requires a guardian to assist him or her to supplement this limited capacity or contract on his or her behalf. A minor also requires the assistance of the guardian in court.
5. When considering the liability of minors on unassisted contracts, the courts distinguish between innocent and fraudulent minors to decide whether the minor may be granted restitution.

QUESTIONS

Short questions (1–5 marks)

1. What does ‘capacity to contract’ mean?
2. What is a juristic person?
3. What is insolvency?
4. Define what is mean by a minor.
5. List five examples of contracts an unassisted minor may enter into validly.

Paragraph questions (5 marks)

1. Is it true that only the parties to a contract may sue or be sued on the contract?
2. Discuss self-imposed formalities on the capacity to enter into contracts.

3. What is the effect of intoxication on the capacity to enter into a contract?
4. What is the effect of prodigality on the capacity to enter into a contract?
5. Discuss how the accrual system operates in contracts of marriage.

Essay questions (10 marks)

1. How can a minor enter into a valid contract?
2. Write notes on the ability of minors to enter into contracts and their liability for contracts fraudulently entered into.

Problem questions (20 marks)

1. Paul is 17 years old and lives in Johannesburg with his parents. He has just completed his apprenticeship as a plumber and wants to start his own business in Cape Town. He wants to rent a flat and he wants to buy a vehicle. In what circumstances may Paul enter into a valid contract on his own for the flat rental and vehicle purchase?
2. Murray, aged 17 years, buys a motorcycle from Dan, a dealer. Murray is still living with his parents, but has a job and pays board and lodging to his parents. Murray's father did not approve of Murray's purchase of the bike, but his mother thought it was a nice bike. A week after the purchase, Murray collides with a fire engine and destroys the bike completely. Murray now refuses to pay the balance of R20 000, which he still owes on the bike. Dan wants to sue him. Discuss the legal positions of both parties.
3. Jacob is a problem child aged 16. He smokes tik and refuses to go to school because he wants to be a gangster. One day he steals a car and sells it to a second-hand car dealer for R20 000. He uses the money to buy a fake ID book showing him to be 18 years old. With the fake ID he opens a bank account with a credit card. He goes online onto eBay, and fraudulently puts up a diamond ring for sale for R100 000. A rich person overseas buys the ring and sends the money to his bank account, but Jacob never sends them the ring. Advise Jacob, and all the other parties of their legal rights.

4. Nsiki married Skollie in 1980 in community of property. Over the years he has treated her badly: he beats her when he gets drunk and takes all her money from her job. Nsiki wants to leave her job and open her own business called ‘Hardware Heaven’. She asks for your advice. Can she place orders for goods without Skollie's permission? Is Skollie liable for the business debts? Can she sell the business and keep the money for herself?

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1 Boberg, *The Law of Persons and the Family*, 529; Fouché, 85; Gibson, 17–29; Havenga et al., 63–67; Sharrock 41–52; Swanepoel et al., 37.

2 Kahn, *Contract and Mercantile Law through the Cases*, 5.

3 Children's Act 38 of 2005.

4 Matrimonial Property Act 88 of 1984.

5 Mental Disorders Act 38 of 1916.

6 Mental Health Act 18 of 1973.

7 *Molyneux v Natal Land and Colonization Co Ltd* [1905] AC 555.

8 *Uys v Uys* 1953 (2) SA 1 (E).

9 *Prinsloo's Curators Bonis v Crafford and Prinsloo* 1905 TS 669.

10 Ibid.

11 *Van Metzinger v Badenhorst* 1953 (3) SA 291 (T).

12 *Vather v Dhavraj* 1973 (2) SA 232 (N).

13 *Wolman and others v Wolman* 1963 (2) SA 452 (A); *Guardian National Insurance Co Ltd v van Gool NO* 1992 (4) SA 61 (A).

14 Section 1(1) of the Guardianship Act 192 of 1993.

15 Section 1(2) of the Guardianship Act 192 of 1993; Van Loggerenberg, D, Dicker L and Malan J, Civil Procedure: The new Children's Act, *De Rebus*, Pretoria: Law Society of South Africa, November 2007.

16 Section 20(2), of the Child Care Act 74 of 1983.

17 *Edelstein v Edelstein NO* 1952 (3) SA 1 (A).

18 Ibid.

19 Boberg, *The Law of Persons and the Family*, 568; Fouché, 62–67; Gibson, 17–24; Havenga et al., 63–67; Sharrock, 41–44; Swanepoel et al., 37–40.

20 *Marshall v National Wool Industries Ltd* 1924 OPD 238; *Skead v Colonial Banking and Trust Co Ltd* 1924 TPD 497; *Van Dyk v South African Railways and Harbours* 1956 (4) SA 410 (W).

21 *Van Dyk v South African Railways and Harbours* 1956 (4) SA 410 (W).

22 *Baddeley v Clarke* (1923) 44 NLR 306.

23 *Wood v Davies* 1934 CPD 250.

24 Ibid.

25 Hahlo and Kahn, 89.

26 Section 26(1) of the Marriage Act 25 of 1961.

27 Recognition of Customary Marriage Act 120 of 1998.

28 Civil Union Act 17 of 2006.

29 Marriage Act 25 of 1961.

30 Boberg, *The Law of Persons and the Family*, 381.

31 *Dickens v Daly* 1956 (2) SA 11 (N).

32 *Dama v Bera* 1910 TPD 928.

33 *Ahmed v Coovadia* 1944 TPD 36.

34 Ibid.

35 *Dama v Bera* 1910 TPD 928.

36 *Grand Prix Motors WP (Pty) Ltd v Swart* 1976 (3) SA 221 (C).

37 *Stuttaford and Co v Oberholzer* 1921 CPD 855.

38 Ibid.

39 Dicker, L, The effect of the new Children's Act on prescription, *De Rebus*, Pretoria: Law Society of South Africa, November 2007.

40 Children's Act 38 of 2005.

41 Choice on Termination of Pregnancy Act 92 of 1996.

42 National Road Traffic Act 93 of 1996.

43 Post Office Act 44 of 1948.

44 Wills Act 7 of 1953.

45 *Tanne v Foggit* 1938 TPD 43.

46 Ibid.

47 Boberg, *The Law of Persons and the Family*, 584.

48 *Tanne v Foggit* 1938 TPD 43.

49 Boberg, *The Law of Persons and the Family*, 599.

50 *Louw v M J and H Trust (Pty) Ltd* 1975 (4) SA 268 (T).

51 Consumer Protection Act 68 of 2008.

52 Hahlo, 153–243.

53 *Grobler v Schmilg and Freedman* 1923 AD 496; Fouché, 75–82; Gibson, 24–26; Havenga et al., 68–72; Sharrock, 46–51; Swanepoel et al., 40–44.

54 *Reloomel v Ramsay* 1920 TPD 371.

55 *Grobler v Schmilg and Freedman* 1923 AD 496.

56 Matrimonial Property Act 88 of 1984.

57 *Amalgamated Banks of South Africa Bpk v De Goede en 'n ander* 1977 (4) SA 66 (SCA); *Tesoriero v Bhyjo Investments Share Block (Pty) Ltd* 2000 (1) SA 167 (W).

58 Civil Union Act 17 of 2006.

59 Section 5 of the Matrimonial Property Act 88 of 1984.

60 Civil Union Act 17 of 2006.

61 *Fourie and another v Minister of Home Affairs and others* [2005] 1 All SA 273 (SCA).

62 Matrimonial Property Act 88 of 1984.

Chapter 9

Serious intention to contract

'Two things are infinite: the universe and human stupidity; and I'm not sure about the universe.'

ALBERT EINSTEIN (1879–1955)
GERMAN-BORN AMERICAN PHYSICIST WHO DEVELOPED THE SPECIAL AND GENERAL THEORIES OF RELATIVITY

What is covered in this chapter

1 Serious intention

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the third element of the definition of contract – the serious intention to contract. There is no point in holding people liable to arrangements if there was never any intention to be bound. Jokes and invitations to do business should not result in people being held liable. It is important for you to understand the difference between a serious intention to be bound, and marketing efforts that are not meant to be taken seriously.

1 Serious intention

The parties must seriously intend the agreement to result in terms that can be enforced. This means that they must believe that binding legal relations will result.[1] The offer to enter into the contract and to be bound to it, must be firm and not a general statement of willingness to do business.[2] Contracts must be based on a reasonable and serious intention to be binding.[3]

It is possible for parties to agree expressly that there will be no valid contract between them until all the terms are in writing in a formal document, and signed by both of them. In this case there will be no enforceable contract until these formalities have been complied with. This is different to the situation where the parties enter into an agreement, and then decide to put the terms of their agreement in writing and to sign the document. This second situation just means that the document is a record of the agreement that has previously been reached.

Practical difficulties arise when negotiations break down after the parties have agreed on some things but not on others. If any of the matters not agreed to is material, then the parties lack the serious intention to be bound on the contract. Whether or not a term is material will depend on the intentions of the parties in each case: did they intend to reach agreement with the other party regarding that issue? It is also possible for the parties to agree to leave some issues to be negotiated at a later date, and still have a valid, binding agreement.

English law applies the ‘doctrine of valuable consideration’, which means that the contract is not valid unless the other party gives, promises, or does something in return. South African courts rejected the doctrine of valuable consideration and have adopted the principle of *justa causa.* This simply means that as long as the agreement is made for a good reason that is seriously intended by the parties to be binding on them, it will be enforceable under South African law.[4]

In our modern society, there are many marketing efforts designed to sell goods. Obviously, not all of them indicate a serious intention to be bound by contract:

- **Pamphlets and brochures**: These do not indicate an intention to be bound by a contract. They are considered marketing devices and are used only to raise awareness of products. They simply provide information to enable someone who is interested in a product or service to enter into a contract at a later stage.
- **Price lists and catalogues**: These are only statements of intent to do business. Just giving information is not an offer. It is the prospective buyer who makes the offer in these cases. For example, when someone reads of a good price for a product and then goes to a shop to buy it, that person makes an offer to the shopkeeper, who may then accept the offer.
- **Advertisements**: These are normally seen as invitations to do business. Only in a few rare cases do these amount to an offer. For example, when the advertisement states specifically that it is an offer. Another example is when the offer is a ‘general offer’. This is an offer to do business with whoever performs certain acts. In this way an advertisement offering a reward for giving information can be accepted by the first person to provide the information.
- **Agreements of a social nature**: These are verbal agreements, or those entered into through sarcasm or as a joke. For example, an arrangement to go to lunch. These agreements are not intended to create contractual liability.[5]

Lucy v Zehmer[6]

The court was told Zehmer had previously verbally agreed to sell a farm to Lucy, but later reconsidered and the land was not sold. Some years later, Lucy entered a restaurant owned by Zehmer with a bottle of whiskey. He and Zehmer drank a lot and discussed the possible sale of the farm. Zehmer wrote a note stating, ‘We hereby agree to sell to W.O. Lucy the Ferguson Farm complete for $50,000.’ The note was signed by Zehmer and his wife, who had initially refused to sign, but later agreed when Zehmer assured her privately that the whole thing was just a joke. When sued, Zehmer claimed that Lucy should have known he was too drunk to agree to the sale.

The court held that Zehmer was not drunk to the point of being unable to understand the nature and consequences of the document he signed. Further, the circumstances surrounding the transaction were such that Lucy was justified in believing that it was a serious business transaction, rather than a mere joke. If the words or other acts of one of the parties have only one reasonable meaning, then that party's undisclosed intention is

immaterial except when an unreasonable meaning which he or she attaches to his or her manifestations is known to the other party.

PRACTICALLY

SPEAKING

Ten tips to writing business plans

One of the most important things to do when starting a new business is to write a business plan. Thinking about what will be in the business plan helps to clarify your thoughts and to pay some attention to things that might not otherwise have been looked at properly. Business plans are considered vital if you ever want to raise finance or take out a business loan. Investors and banks want to know how you plan to grow the business and what resources you are putting into making your business succeed.

1. **Research**: Your idea for the new business might be a good one, but your business will not succeed if you do not know what your customers want, what your competition is doing, and what challenges are expected in the 12 months ahead.
2. **Realism**: There is no point in being over-optimistic about the future potential of your business. This will simply set you up for failure when your inflated targets are not achieved. Investors will be scared off if your predictions are unrealistic.
3. **Emphasise your unique strengths**. If there is nothing special about your business, why should anyone buy from you?
4. **Understand your competitors**: Try to predict what the competition may do when they find out that there is a new business in the market. Even if they may not currently be interested in the area in which you operate, once they find out there is a profit to be made you can expect them to become very interested. How will you survive if they sell goods or services cheaper than you, or provide better service?
5. **Realistic risk analysis**: What are the current strengths and weaknesses, and future risks and opportunities faced by the new business?
6. **Bold executive summary**: This is the first part of the business plan. Make sure you write it so that it is bold and straightforward, real without being overdramatic. The executive summary needs to impress bankers and potential partners, and it must be a short summary of the business plan.
7. **Write a structured business plan**: Start with the objectives, and follow the standard format to end at a solid conclusion. Standard templates can be downloaded from the internet, or if you are intending to obtain finance from a bank, it is possible that the bank will have a template business plan for you to follow.
8. **Write the plan to suit your audience**: You need to be strategic and write the plan to impress the people who read it.
9. **Have you planned for the future?** An entirely legitimate aim is to grow a new business with the objective of selling it at a profit. Is it your plan to keep on growing the business, or to increase its value to sell it? Do you want to control the business in future, or are you happy to sell your majority of shares?
10. **Business plans change**: Your business plan must be updated as time goes by to reflect changes in your environment.

THIS CHAPTER IN ESSENCE

1. Contracts must be based on a reasonable and serious intention to be binding.
2. Marketing efforts designed to sell goods may not indicate a serious intention to be bound by contract. For example, advertisements are generally seen as ‘invitations’ to do business.

QUESTIONS

Short questions (1–5 marks)

1. What is the meaning of ‘serious intention’?
2. What does the ‘doctrine of valuable consideration’ mean?
3. What is the meaning of *justa causa*?

Paragraph question (5 marks)

1. Write notes on whether a social arrangement is meant to be taken seriously as an offer to enter into a contract.

Essay question (10 marks)

1. Write notes on whether pamphlets, catalogues and advertisements generally are meant to be taken seriously as offers to enter into contracts.

Problem question (20 marks)

1. Mohamed is very attracted to Preeti, and promises her R1 000 to go out with him to dinner. She agrees, but does not arrive at the restaurant. He is very upset and sues her. Discuss the rights of both parties.

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1 Kahn, *Contract and Mercantile Law through the Cases*, 183.

2 *Crawley v Rex* 1909 TS 1105; *Efroiken v Simon* 1921 CPD 367.

3 *Rood v Wallach* 1904 TS 187; Fouché, 36–37; Gibson, 29–31; Sharrock, 80–84.

4 *Conradie v Rossouw* 1919 AD 279; *Rood v Wallach* 1904 TS.

5 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Lucy v Zehmer* 196 Va 493 84 S.E. 2d 516 (1954).

6 *Lucy v Zehmer* 196 Va 493 84 S.E. 2d 516 (1954).

Chapter 10

Communication – offer and acceptance

'You can fool all the people some of the time, and some of the people all the time, but you cannot fool all the people all the time.'

ABRAHAM LINCOLN (1809–1865)
PRESIDENT OF THE UNITED STATES OF AMERICA

What is covered in this chapter

1 Communication

2 Contracts accepted through the post

3 Contracts accepted by telephone, fax, internet, and e-mail

4 Offers that introduce special terms

5 Rules of offer and acceptance

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the fourth element of the definition of contract – communication and the rules of offer and acceptance.

Every day, people say and do things without intending to be bound on a contract. We have already seen in previous chapters that invitations to do business and providing information do not create contracts. But how does the law separate these events from those in which people do or say things and intend there to be an agreement?

Our law tries to understand what the parties intended at the time. It analyses their communications to give an insight into whether they intended there to be a contract or not. The communications between the parties are looked at in two parts – firstly, the offer that was made, and secondly, the acceptance of that offer.

In this chapter we look at the common-law rules of offer and acceptance to help us understand when the parties have reached agreement. Generally, there can be no contract if one party does not agree. But how do we know if people have agreed to the terms of a contract? What legal effect do the words have on public signs, or on the tickets and receipts we are given when we buy things? How do we know if someone has agreed to a contract when we buy something over the internet, or through the post?

Our common law has developed rules to explain when these words will affect our contracts, and the circumstances they will not. There are also laws to protect consumers which provide additional rules and remedies for transactions which are covered by those laws.

1 Communication

The parties should make each other aware of their intentions in terms of the contract. Communication usually takes place by spoken or written words, or even through conduct. At its most basic level, a contract is a form of agreement between the parties. Legally this is known as a ‘meeting of the minds’ or consensus.

As a general rule, every contract or agreement is reducible to an offer and an acceptance.[1] By looking at whether or not there was an acceptance of an offer, courts can decide if there was an agreement or not, and also where and when the agreement was entered into.

- **Offer**: An ‘offer’ is a proposal that expresses a person's willingness to become a party to a contract, to comply with the terms expressed, and to be bound contractually if another person accepts.

  An offer must be communicated to the person with whom contractual relations are intended. The person who makes an offer is called the ‘offeror’.

  The offeror can withdraw or revoke the offer at any time, provided it has not yet been accepted. Once accepted it cannot be revoked.[2] In the absence of a time period being specified for acceptance, the offer must be kept open for a reasonable time period before it expires or ‘lapses’. The offer will terminate on rejection. Provided no acceptance has taken place, the offer will lapse on the death of either party.
- **Acceptance**: The person who accepts an offer is called the ‘offeree’. An ‘acceptance’ is the express or implied signification by the offeree of his or her intention to be bound contractually in terms of the offer made. The offeree must express his or her intention to be bound.

  The acceptance must be consistent with the terms of the offer. The acceptance must take place in the way prescribed by the offeror. If the person to whom the offer is made does not accept the terms as offered, then the offer is rejected and terminates. For example, a counter-offer results in the termination of the original offer.

Silence does not amount to consent, unless the law imposes a duty to speak.[3] Where there is a duty to speak and it is not complied with, the law may deem silence to amount to consent. The only time that silence will be deemed consent is where the only possible explanation for the silence is that tacit acceptance has taken place.

- **Option**: An option is an agreement in terms of which the person granting the option (grantor) agrees to keep an offer open to someone else (grantee) for a specific time.[4] For example, an offer to purchase property or an option to extend a lease.

  An option cannot be withdrawn during the time period for which it is granted. If no time period is specified, it lapses after a reasonable time. An option is therefore different to an offer which is open for a limited time. This type of offer can be withdrawn during the time period it is open.

  Options may be ceded; offers may not.[5] An option lapses on lack of capacity of one of the parties or after a reasonable time. An option ends on outright rejection or by a counter-offer. Where the offer that is being kept open by the option must meet formalities, for example, it must be in writing or signed, then the option must also comply with these formalities to be valid.[6]

  Where an option is breached, the aggrieved party may apply to court for an interdict and claim damages to recover any losses suffered as a result of the breach. The damages would place the aggrieved person in the position he or she would have been in if the option had never been agreed to at all, or if the breach had never occurred.[7]
- **Right of first refusal**: A person who grants a ‘right of first refusal’ (grantor) agrees to make an offer available for acceptance first by a specific person (grantee) before anyone else. If the grantee rejects the offer the grantor can then make it open to others. A right of first refusal can also be called a ‘right of pre-emption’.

2 Contracts accepted through the post

At what point is an offer accepted when the acceptance takes place through the post? There are four theories:[8]

- **Declaration theory**: Acceptance occurs when the offeree has expressly stated acceptance. For example, the offeree writes the letter of acceptance.
- **Expedition theory**: When the offeree posts the letter of acceptance.
- **Reception theory**: When the letter of acceptance reaches the offeror's address.
- **Information theory**: When the letter of acceptance reaches the mind of the offeror. This means that acceptance happens when the letter is read.

Although the information theory satisfies the theoretical requirements of a meeting of the minds for contracts accepted through the post, for reasons of commercial convenience South African law follows the expedition theory for the acceptance of an offer, and the information theory for the revocation of an acceptance of an offer for these contracts.[9]

The effect on commercial contracts is that an offer made by post contains an implied term that posting a letter of acceptance will constitute acceptance and create a binding contract. Provided that the letter of acceptance is correctly addressed and stamped, there will be a binding contract from the moment of posting even if the letter is delayed or lost in the post, or if the offeror never receives it or reads it. It is, however, always open to the offeror to state that there shall be no contract unless the letter actually reaches the offeror. The expedition theory does not apply under exceptional circumstances, for example where postal communications have been disrupted by strike or war.[10]

The posting of a letter rejecting an offer does not take effect on posting. This means that the offer can still be accepted by a means that reaches the mind of the offeror more quickly than the rejection. For example, if I post a letter to you rejecting the offer, and then telephone you before the letter reaches you, I will still be able to accept the contract over the telephone. Likewise, revocation of the offer is only effective when it reaches the mind of the offeree. Therefore, an offer is still open for acceptance when a letter

revoking it has been posted by the offeror, but has not yet reached the offeree.[11]

3 Contracts accepted by telephone, fax, internet and e-mail

The modern position for contracts accepted by telephone follows the information theory, that is, acceptance takes place only if the offeror actually hears it. Acceptance will occur at the place where the offeror hears the acceptance and at the time he or she hears it.[12]

S v Henckert [13]

A contract to purchase semi-precious stones was entered into by telephone between a buyer in Namibia and a seller in South Africa. The contract was illegal in terms of South African law, but not Namibian law.

The court found that the buyer had heard the acceptance in Namibia, and therefore the contract was entered into in Namibia and was not illegal.

The reception theory applies to contracts accepted by fax, internet or e-mail. In these cases, a contract comes into existence at the place where the acceptance is received by the offeree and at the time he or she becomes capable of reading it.[14]

4 Offers that introduce special terms

Generally, the law will not interfere in contracts between parties as it assumes that the parties are in an equal bargaining position, are not forced to contract, and are in the best position to decide the terms of their contract for themselves. However, this is not always true. Examples of imposed terms include notices displayed on walls or in public spaces that exempt the owners from liability in case of damage to property or injury. To what extent are people bound by the terms on notices, signs, receipts, and tickets?

4.1 The common-law position

As a general rule under our common law, a person seeking to impose special terms in a contract must take all reasonable steps to ensure that the other party is made aware of their existence. If the other party then sees and understands the terms, or knows of their existence, then he or she will be bound by them.[15]

4.1.1 Signs and notices

Where a notice is displayed so conspicuously that a normal person could hardly fail to see it, it will be assumed that the person did in fact see it and is bound by its terms. However, if a proprietor realises that the person does not understand the notice, he or she cannot rely on that person being bound by the terms. This has particular relevance for a multilingual society like South Africa.

Under the common law, liability for negligence can only be excluded by specifically stating that the proprietor will not be liable for negligence.[16] The courts will also generally consider the conspicuousness of the notice, prominence of writing on the notice, and the opportunity provided to a customer for reading the notice.[17]

***Davidson v Johannesburg Turf Club*[18]**

A man claimed he was wrongfully arrested. The defendant relied on the conditions of admission contained in notices displayed at the club.

The court held that the conditions of admission to the race club were in notices displayed at the club and at all the entrances to the course, and the conditions of admission were published in all the Johannesburg newspapers.

The court held that ‘Everything was done that the stewards could do to bring to the notice of the public that such conditions were attached to the admission to the race course; and under these circumstances any member of the public who attends a race meeting must be taken to attend subject to the conditions imposed by the stewards, whether he personally had notice of the conditions or not.’

Central South African Railways v James[19]

The defendant relied on notice boards containing terms relating to a contract.

The court held that where a patron reads and accepts the terms of the notices there would be actual consensus and the patron would be bound to those terms. Had the patron seen one of the notices and realised that it contained terms relating to the contract but did not bother to read it, there would similarly have been actual consensus on the basis that the patron would have agreed to be bound to those terms, whatever they might have been.

Davis v Lockstone [20]

A guest's luggage was stolen while he was staying at an inn. He instituted action against the inn and argued that the inn should be held strictly liable for his loss in terms of the Praetor's Edict. This is an old Roman law proclamation called the *Praetor's Edict de nautis cauponis et stabularis* (concerning mariners, innkeepers, and stable keepers). This Praetor's Edict provides that: ‘Where mariners, innkeepers, or stable keepers have received the property of anyone for safekeeping, then, unless they restore it, I will give judgment against them’.

The court confirmed that the Praetor's Edict was part of South African law. The only exception to the liability would be if the loss was found to be occasioned by superior force or *vis major*. The court held that the fact that access to the inn had been gained either through the door or window did not constitute an act of violence.

The court held that the innkeeper could not limit his common-law duty merely by posting up a notice to this effect in his hotel without proof that the plaintiff had read and agreed to the terms.

Olley v Marlborough Court Ltd [21]

A hotel defended an action by a guest that the hotel had been negligent in allowing the theft of her luggage. A notice had been displayed in each bedroom disclaiming any liability.

The court held the hotel liable, as the notice was only seen after guests had been accepted to stay at the hotel.

Gabriel and another v Enchanted Bed and Breakfast CC [22]

The plaintiffs sued the owners of a guesthouse following the theft of their property during their stay. They argued that the defendant should be held strictly liable for the loss

suffered under the Praetor's Edict.

The defendant claimed that a notice was displayed on the double doors at the entrance to the premises. The notice read that ‘The owner and the staff will not be held liable for any loss or damage sustained by whatsoever cause’. A similar notice was displayed in a brochure that the plaintiffs had been given on their arrival at the hotel. After the incident the guesthouse posted a similar sign at the registration desk.

The plaintiffs testified that they had never seen the notice at the entrance and that they did not read the brochure until after the incident, and that the sign was never pointed out to them and their attention was not drawn to the notice contained in the brochure.

The court held that the plaintiffs were unaware of the notice on the front door and in the brochure, and that there could be no question of them ever having agreed to the terms of the notice.

The common law has been amended by the Consumer Protection Act[23] in respect of certain transactions. Provided the activity is covered by the Act, most exemption clauses or limitations of liability will be valid if the clause is fair, just and reasonable; in writing and in plain language; the nature and effect of the provision was drawn to the attention of the consumer before the consumer concluded the transaction or was required to pay; and the consumer was given an adequate opportunity to understand the meaning and effect of the provision.

However, the Act has extra requirements for agreements to limit liability concerning an activity or facility subject to risk. Where the activity or facility is unusual or the consumer could not reasonably have known of the risk or the activity could result in serious injury, there are two additional obligations on the supplier: the consumer must be given time to understand the provision, and must sign his or her agreement next to the provision.

As a result of this requirement under the Act it will almost be impossible for proprietors of public facilities in which there is any possibility of someone being injured to use notices to exclude or limit liability. Details of the protections offered to certain transactions by the Act are covered later in this chapter, as well as separately in more detail in chapter 30 on consumer protection.

4.1.2 Tickets

Was the offeree aware, or ought to have been aware, at the time of acceptance that the offer was subject to certain terms? Most tickets are

given out after the contract has come into existence, and the offeree therefore cannot be held liable for any terms printed on them.[24]

Central South African Railways v McLaren [25]

The railway was held liable for loss from a locker despite issuing a ticket with a term disclaiming liability.

The court held that a cloakroom ticket was not a document that a person would reasonably believe contained terms and conditions, the ticket was difficult to read, and no one had done anything to bring the person's attention to the existence of the terms on the ticket.

Chapelton v Barry Urban District Council [26]

A man at the beach hired two deck chairs. A sign next to the chairs said they were for hire at a certain charge for three hours. Members of the public were requested to get tickets from an attendant and to keep the tickets for inspection. The man bought two tickets and did not read them. He was injured after he sat down, the chair collapsed and the canvas tore. The council argued that they were not liable as the ticket had an indemnity printed on it.

The court did not agree, and found that the man was entitled to claim damages for injuries sustained. The purpose of the ticket was simply, like a receipt, to provide proof of payment.

4.1.3 Receipts

Terms and conditions printed on receipts do not form part of the offer. The person taking a receipt does not generally bind himself or herself in terms of clauses printed on the receipt. A receipt is only proof of payment and is not meant to introduce terms to bind the parties. The contract has already been entered into by the time the receipt is issued.[27]

A person who alleges that a special term formed part of the contract must prove the existence and applicability of that term. This is consistent with the general principle: ‘He or she who alleges must prove’. If a person sues, and is met with a defence that a special term exempted the defendant from liability, the person suing must prove that there was no such special term.[28]

Under the common law, the person seeking to hold the other bound by the special term must prove four things to succeed:

- The term was in contractual form.[29]

- The term was contemporaneous with the contract. This means that the term was known at the same time that the agreement was made, and not introduced afterwards.[30]
- The term was read and understood by the person sought to be bound by it.[31]
- All reasonable steps were taken to draw the other person's attention to the term.[32]

Yeats v Hoffweg Motors [33]

A sign at a garage stated that all vehicles were parked there at the owner's risk.

The court adopted the test of whether a reasonable person in the circumstances ought to have been aware of the existence of the sign. On the facts the garage had taken reasonable steps to bring the sign to the attention of customers and consequently the terms on the sign were part of the contract.

Durban's Water Wonderland (Pty) Ltd v Botha and another [34]

The Plaintiff said that she had been aware of notices on the premises, but alleged that she did not see the notices on the evening of the incident or any other time. The water park had to establish that she was bound by the terms of the disclaimer notice based on some type of mutual consent.

The court had to decide whether the park had been reasonably entitled to assume from her conduct in parking and attending at the premises that she agreed to the terms of the disclaimer, or was prepared to be bound by them without having read them.

The court held that the answer depends on whether, in all the given circumstances, the park had done what was reasonably sufficient to give notice to patrons of the terms of the disclaimer clause.

4.1.4 Contracts entered into remotely

Increasingly, contracts are entered into by fax or internet, where a party seeks to hold another liable to terms and conditions that are transmitted later, or sometimes, not at all. In some cases the terms may only be referred to briefly.

A contracting party who wants to include standard terms on the reverse of a document must ensure that the reverse of the document is transmitted to the other contracting party before the terms of the contract are agreed. The terms and conditions must be clear and unambiguous, and reference to the terms should be prominently contained in the part of the document where one would expect to find contractual terms.

Reference to standard terms and conditions on the reverse of the document should not be printed to form part of the letterhead or company details. The party seeking to impose the terms and conditions should retain proof of transmission of both the front and reverse of the document, including the standard terms. The document should contain a provision for signature to show agreement with the standard terms and conditions.

***Cape Group Construction (Pty) Limited t/a Forbes Waterproofing v The Government of the United Kingdom*[35]**

The plaintiff had been requested to repair the roof of a house owned by the Government of the United Kingdom. A one-page quotation was faxed on a standard letterhead. Details of the roof repairs were in bold large print. The words 'see terms and conditions overleaf' were the smallest and lightest of print on the document. The overleaf provisions were not sent. They referred to a very wide limitation of liability for loss or damage. The issue was whether Forbes had done what was reasonably sufficient to bring to the Government's attention the conditions of contract.

The court held that the words 'see terms and conditions overleaf' does not convey that there are standard terms available for inspection if the addressee wished to see them. The natural meaning was that if no additional terms or conditions are transmitted there are none applicable to the particular contract. This meant that non-attendant terms and conditions did not form part of the contract.

The court held that Forbes failed to take reasonably sufficient steps to bring the contractual terms to the attention of the Government. Reference to the terms could easily have been inserted in the body of the fax, and the reverse of the document containing the standard terms faxed. Alternatively, the words referring to the contractual terms could have been given greater prominence in some manner or other. In the circumstances, Forbes was not entitled to rely on its disclaimer of liability.

4.2 Statutory protection for transactions covered by the Consumer Protection Act [36]

If the agreement is a transaction covered under the Act, then the common-law position is changed and the parties will have extra protection provided by the statute. Agreements that are not covered by the Act will not have the extra protections, and the common-law position will still apply. Refer to chapter 30 on consumer protection in this text to see which transactions are covered by the Act, and which are not.

4.2.1 Information in plain and understandable language

The Consumer Protection Act[37] requires that certain documents must be in plain and understandable language. This means that it must be reasonable for an ordinary consumer to understand the content and effect of the document. An ordinary consumer is someone with average literacy skills and minimal experience as a consumer of that type of goods or service. The language must be clear, fair and easy to understand by an ordinary consumer with average literacy skills and minimal experience of the type of goods or service.

4.2.2 Unfair, unreasonable or unjust contract terms

If a transaction is covered by the Consumer Protection Act,[38] then the law will prohibit contractual terms that are unfair, unreasonable or unjust, and require notice to be given for certain other terms that limit the risk of a supplier.

What is ‘unfair, unreasonable or unjust’ is not defined in the Act. However, the Act provides examples such as:

- The term or the agreement is so adverse to the consumer as to be inequitable, or is excessively one-sided in favour of another person.
- The consumer relied on false, misleading or deceptive representation to his or her detriment.
- The nature or effect of clauses limiting the liability of the supplier is unfair or unconscionable or was not drawn to the attention of the consumer.

The Act also provides factors for courts to consider when determining whether something is unfair. For example, whether there was any opportunity for negotiation between the parties or whether there have been previous dealings between the parties. Standard form contracts leave little to no room for negotiation by the consumer and can be found to be unfair by the courts. If a provision is found to be unfair it, or the entire contract, is unenforceable.

The court must consider a variety of factors in deciding whether a term is unfair, including:

- The fair value of the goods or services.

- The nature of the relationship between the parties.
- The circumstances of the transaction, and whether the consumer ought to have known of the term given a custom of trade and any previous dealings between the parties.

Where a term is found to be unfair, a court may order the purchase price to be repaid or property given back to a consumer; to compensate the consumer for losses and expenses; or to require the supplier to stop a practice.

4.2.3 Notice required for certain terms and conditions

Certain terms may limit the risk or liability of the supplier in transactions under the Consumer Protection Act.[39] This can be done by requiring the consumer to assume risk or liability or to indemnify the supplier, or to acknowledge a fact about the goods or service. If these terms are found to be unfair they will be unenforceable.

Most exemption clauses or limitations of liability will be valid if certain requirements are met:

- The clause must be fair, just and reasonable.
- It must be in writing and in plain language.
- The nature and effect of the provision must be drawn to the attention of the consumer before the consumer concludes the transaction or is required to provide payment.
- The consumer must be given an adequate opportunity to understand the meaning and effect of the provision.

4.2.4 Warning concerning fact and nature of risks

The Consumer Protection Act[40] requires extra requirements for agreements under the Act that concern an activity or facility subject to risk. Where the activity or facility is of an unusual nature; or the consumer could not reasonably have known of the risk; or that could result in serious injury; there are two additional obligations on the supplier: the consumer must be given time to understand the provision, and must sign his or her agreement next to the provision.

For example, going on a rollercoaster in an amusement park. Normally, one would expect a notice to be placed at the entrance to the ride that excluded the owners and operators from any liability in respect of any personal injury you may sustain. Under the Act, it is not sufficient for a disclaimer notice to be brought to your attention when entering the park. You must be given the opportunity to understand the disclaimer, and to sign your agreement.[41]

5 Rules of offer and acceptance[42]

There are ten rules of offer and acceptance.

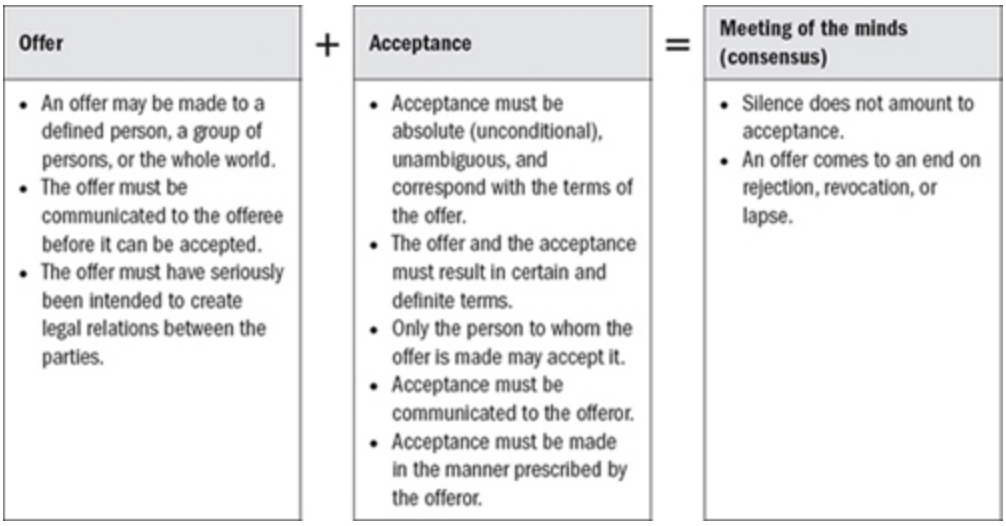
Offer
An offer may be made to a defined person, a group of persons, or the whole world.
The offer must be communicated to the offeree before it can be accepted.
The offer must have seriously been intended to create legal relations between the parties.
+
Acceptance
Acceptance must be absolute (unconditional), unambiguous, and correspond with the terms of the offer.
The offer and the acceptance must result in certain and definite terms.
Only the person to whom the offer is made may accept it.
Acceptance must be communicated to the offeror.
Acceptance must be made in the manner prescribed by the offeror.
=
Meeting of the minds (consensus)
Silence does not amount to acceptance.
An offer comes to an end on rejection, revocation, or lapse.

Figure 10.1 *The ten rules of offer and acceptance*

5.1 An offer may be made to a defined person, a group of persons, or the whole world

Only the person to whom the offer is made may accept it.[43] However, an offer to the world may be accepted by anyone who carries out the act required by the terms of the offer, provided the person knows of the existence of the offer when carrying out the act. Usually such offers are offers for rewards for giving information. Offers of reward are generally interpreted as being limited by implication to the first person to carry out the required act.[44]

5.2 The offer must be communicated to the offeree before it can be accepted

It is not possible for an offer to be accepted if the acceptor did not know of the existence of the offer. For example, a person who did not know of a reward and who performs the required act cannot later claim the reward.[45]

Bloom v American Swiss Watch Company [46]

A company was robbed of some jewellery, and the company placed an advertisement in the press offering to pay £500 for information given to the police leading to the arrest of the thieves. A man learned of the reward only after giving information to the police. He claimed the reward but the company refused to pay him.

The court held that as he had given the information unaware that the company had placed an advertisement saying that it would pay a reward for such information, the company did not have to pay him.

5.3 The offer must have seriously been intended to create legal relations between the parties

Promises made as a joke or social arrangements are not binding.[47] There is also a difference between a firm offer and an 'invitation to do business'. Advertisements of goods for sale in shop windows, newspapers, and catalogues at certain prices are not considered offers, but are just invitations to do business.[48]

Crawley v Rex [49]

A customer who saw a placard advertising tobacco at a reduced price went into the shop and bought some tobacco at that price. He left, and returned shortly after, asking to buy more. The shopkeeper refused to serve him. He refused to leave without the tobacco, and the shopkeeper called the police, who charged him with the offence of refusing to leave the premises.

In court he argued that he had accepted the offer to sell made by the shopkeeper and was therefore entitled to be in the shop to take delivery.

The court held that the notice amounted to an invitation to do business, and not an offer to sell. There was nothing that required the shopkeeper to sell the goods to someone who walked in and tendered the advertised price.

In modern society it is sometimes not easy to determine when an offer is made and when it is accepted.

- **In a self-service shop**: The offer takes place when the customer tenders the purchase price to the cashier, who may then accept the offer. The fact that goods are on shelves does not constitute an offer, and there is no acceptance when the item is taken from the shelf.[50]

Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd [51]

A shop had a pharmacy department with certain drugs, the sale of which was controlled by legislation. The law provided that the drugs could only be sold under the supervision

of, or by, a registered pharmacist. A customer put certain of these drugs into his basket and paid for them at the cashier.

The court held that the shop did not break the law as the customer had made an offer to buy, which was accepted at the cashier's desk under the supervision of the registered pharmacist.

- **Request for tenders**: This is generally not an offer, but an invitation to submit a tender. Each tenderer makes an offer and there is normally no need for the person calling for tenders to accept any tender.
- **Auction sale without reserve**: 'Without reserve' means that there is no lowest price that will be accepted; the item will definitely be sold to the highest bid. At an auction sale without reserve, putting up the article for auction constitutes an offer and each bid is an acceptance under the condition that there is no higher bid.[52] The bidder must act in good faith. A bid made dishonestly or in bad faith is not an offer, and is not binding on the auctioneer or the seller.[53]

  The auctioneer must take reasonable steps to notify the public that the auction sale is one without reserve. This may be done by publication in an advertisement or reading the terms out before the auction starts. Failure to take these reasonable steps means that the auction will be one with reserve.
- **Auction sale with reserve**: 'With reserve' means that there is a minimum price that can be accepted. At an auction sale where the sale is with reserve, putting up the article for auction is an invitation to do business. The auctioneer requests bids. Each bid is an offer, each offer lapses when a higher offer is made. Once a bid is higher than the reserve price, the highest bid is accepted by the auctioneer.

If the auction is a transaction covered by the Consumer Protection Act[54] then a bid may be withdrawn before the fall of the hammer or before it is announced that the auction is complete. Notice must be given in advance if a sale by auction is subject to a reserve price; or if it is subject to a right to bid by or on behalf of the owner or auctioneer, in which case that person must also be present at the auction.

In some cases it is possible for an advertisement to amount to an offer. The court will examine the nature of the advertisement, the wording, and the surrounding circumstances.

Carlill v Carbolic Smokeball Company [55]

A company advertised that it would pay £100 to someone who caught influenza despite using a certain machine three times daily. It further stated that it had placed £1 000 in a bank account as a demonstration of its sincerity. The plaintiff bought the smoke ball on the strength of the advertisement, and used it as instructed. She caught influenza, and sued the manufacturers.

The court held that because the company had actually placed the £1 000 into a bank account, by their conduct they had represented that the advertisement amounted to more than an invitation to do business. The public was therefore justified in thinking of the advertisement as a firm offer.

An advertisement with the words, 'First come, first served,' can also amount to an offer.[56]

5.4 The acceptance of the offer must be absolute (unconditional), unambiguous, and correspond with the terms of the offer

The acceptance must comply with the terms of the offer relating to the method, time and place of acceptance.

An acceptance subject to conditions is not regarded as an acceptance of the offer. It is a rejection of the original offer and is considered a counter-offer that the original offeror may accept or reject. The original offer, having been rejected, lapses and is no longer open for acceptance.[57]

A request for information or a suggestion to modify terms does not amount to a rejection of the original offer.[58]

Watermeyer v Murray [59]

An offer for the sale of land stated that a deposit of a certain amount had to be paid on signature of the agreement. The buyer indicated his acceptance of the offer but stated a different date for the deposit to be paid.

The court held this amounted to a rejection of the offer, and that a counter-offer had been made.

There must be no doubt that there has been an acceptance of the offer. If there is any reasonable doubt in the circumstances then there has been no acceptance.[60]

CARBOLIC SMOKE BALL

WILL POSITIVELY CURE

COUGHS | CATARRH | HEADACHES | THROAT DEAFNESS | INFLUENZA | CROUP

COLD IN THE HEAD | ASTHMA | LOSS OF VOICE | SNORING | HAY FEVER | WHOOPING COUGH

COLD ON THE CHEST | BRONCHITIS | SORE THROAT | SORE EYES | HEADACHE | NEURALGIA

As all the Diseases mentioned above proceed from one cause, they can be Cured by this Remedy

£100 REWARD

WILL BE PAID BY THE

CARBOLIC SMOKE BALL CO.

to any Person who contracts the Increasing Epidemic,

INFLUENZA,

£1000 IS DEPOSITED

THE CARBOLIC SMOKE BALL,

TESTIMONIALS.

AS PRESCRIBED BY

SIR MORELL MACKENZIE, M.D.,

H.I.M. THE GERMAN EMPRESS.

TESTIMONIALS.

The Originals of these Testimonials may be seen at our Chemical Works, with hundreds of others.

One CARBOLIC SMOKE BALL will last a family several months, making it the cheapest remedy in the world at the price—10s., post free.

The CARBOLIC SMOKE BALL can be refilled, when empty, at a cost of 5s., post free. Address:

CARBOLIC SMOKE BALL CO., 27, PRINCES ST., HANOVER SQ., LONDON, W.

Figure 10.2 *The original newspaper advertisement for the Carbolic Smoke Ball* [61]

Boerne v Harris [62]

A tenant wrote to renew a lease in accordance with a term requiring the notice of renewal to be at least six months prior to the expiry date. The tenant used as the proposed date of renewal the date on which the letter was written, instead of the date of expiry, which was six months later. The landlord did not acknowledge receipt of the letter.

The court held that the tenant had not exercised the right of renewal and that the lease had terminated.

Mens Fair (Pty) Ltd v Bible Society of South Africa [63]

In exercising an option to renew a lease, a lessee wrote 'from 11 November 1973', instead of 'from 1 November 1973'.

The court held that the lessee had made a manifest error and the lessor should have understood that it intended to renew from the correct date.

5.5 The offer and the acceptance must result in certain and definite terms

The agreement will be void because of vagueness if definite terms do not result. The courts will do their best to avoid this conclusion and to give meaning to the words used by the parties.[64] Some terms may be read into the contract by the court, that is, the meanings may be implied by law, circumstances, or trade usage.

For a trade usage to be valid, it must be generally well known, definite, reasonable, legal, and not specifically excluded by the terms of the contract.[65] Trade usage would therefore be common business practice. For example, depending on the type of business involved, a commission may be payable on the sale of goods. The trade usage will be the common business practice as to which of the parties pays the commission.

If a person by words or conduct allows an opinion to form that a certain set of facts exists, and, as a result, causes a second person acting on these representations to be prejudiced, the first person is prevented or 'estopped' from raising as a defence that in truth such a set of facts did not exist. This is known as the 'doctrine of estoppel'. This means that someone in a court case cannot state that a term did not exist, if by his or her own conduct he or she allowed the other party to think that the terms did in fact exist.[66] For example, if a company regularly allows an employee to order goods from a supplier, it cannot later when being sued for payment claim that the employee actually did not have permission to do so.

R v Nel [67]

A buyer living in one place, ordered alcohol from the seller at another place. The liquor was duly sent to the place from where the liquor had been ordered.

The court held that the contract was concluded at the place where the liquor was ordered and at the time when the liquor was sent.

5.6 Only the person to whom the offer is made may accept it

This is true of an ordinary revocable offer, but not always of an option, which involves a right that sometimes may be ceded or transferred to another person. An option is an offer that the offeror has agreed to keep open for a fixed time. Generally, an option to buy for cash can be ceded without the consent of the debtor, whereas an option to purchase on credit may not. This is because the creditworthiness of the debtor is an important factor in commercial contracts.[68]

Bird v Summerville and another [69]

The court dealt with an agreement between a seller and a buyer to sell a certain property. The buyer signed the written offer, together with another person who was not known to the seller at the time he had offered to sell the property.

The court held that the seller had not intended the property to be sold to anyone other than the original buyer.

5.7 Acceptance must be communicated to the offeror

Generally, the offeree must notify the offeror by words or conduct of his or her acceptance. Mere mental agreement is not enough to form a contract. But the offeror may expressly or tacitly do away with the need for communication of acceptance. For example where goods are ordered at a named price. Here, acceptance is constituted by the delivery of the goods to the offeror.[70] An offer of reward is normally accepted simply by carrying out the required act.

Fern Gold Mining Company v Tobias[71]

A person offered by letter to buy shares in a company. The directors agreed, and a letter informing him that the company would allocate him the shares was posted to him in return. After they had agreed, but before he received their letter, he informed the company that he revoked his offer.

The court held that since the offer had not been accepted prior to being revoked, the revocation was effective and there was no contract.

Where the offeror makes it very difficult for the offeror to communicate acceptance, then it will be sufficient if the offeree makes a reasonable attempt to send the acceptance.[72]

5.8 Acceptance must be made in the manner prescribed by the offeror

If the offer stipulates a particular way of acceptance, a binding contract will result even if this method does not lead to actual communication between the parties. Generally, unless the contrary is specifically stated by the offeror, a compulsory method of acceptance is interpreted merely as the preferred mode. Any other method of acceptance will suffice if it brings the acceptance to the mind of the offeror at least as soon as the preferred mode would have done.[73] For example, if the offer states that a letter of acceptance must be posted to a particular P O Box address, and the offeree e-mails the acceptance, a valid contract will still come into existence. However, if the offeror had stated that acceptance could only be made by a letter sent through the post, then e-mail will not be acceptable.

5.9 Silence does not amount to acceptance

The offeree might be silent for many reasons; silence is not a valid indicator of acceptance or rejection. Generally, an offeror cannot state he or she will regard the offeree's silence as amounting to acceptance, for no one can be bound by silence unless it was his or her duty to speak.[74]

A duty to speak, however, may arise from the course of previous dealings between the parties. Sometimes, companies may send someone goods that were not ordered or they may arrive at the wrong address. These are called ‘unsolicited’ goods. Under the common-law rules of offer and acceptance, a party to whom unsolicited goods are sent is not bound and does not have to pay. Because no offer has been accepted, he or she can ignore the goods and just store them on behalf of the offeror. However, if he or she later uses the goods then the usage will constitute acceptance, and then he or she will be bound to pay for them on the contract.

The Consumer Protection Act[75] changes the common-law position for certain transactions covered under the Act. For example, a person who takes possession of these goods may keep them, but may be liable to return the goods to the person to whom they should have been given in the first place. The seller may not demand payment. The person in possession has the choice to keep the goods or return them to the seller at the expense of the seller. The buyer will not be liable for any loss or damage to the goods

unless this is done intentionally. A buyer who makes payment for unsolicited goods can recover payment.[76]

5.10 An offer comes to an end on rejection, revocation, or lapse

An offer will terminate on rejection or on the making of a counter-offer. The offer is then destroyed and cannot be accepted at a future time. In legal terms the offer has 'lapsed'.

An enquiry about terms of the offer is not a counter-offer, and leaves the offer intact. An offer may be revoked at any time before acceptance.[77] Revocation means that the offeror has clearly indicted that he or she no longer wants to enter into a contract. To be effective, notice of revocation must reach the mind of the offeree before acceptance.[78] If the offer is accepted before the revocation reaches the mind of the offeree, then a valid contract will be formed. [79]

***Yates v Dalton*[80]**

A telegraphic offer was made to lease a café. The next day, a telegram was sent accepting the offer. An hour later, the offer was withdrawn.

The court held that since the offer had not been withdrawn before the telegram of acceptance was sent, a valid contract had been created.

If an option has been granted, the offer cannot be revoked until the option has expired.

An offer may also expire by the passing of time, if a time for the acceptance has been fixed by the offeror. Otherwise the offer may lapse after the passing of a reasonable amount of time.[81] The amount of time considered reasonable will depend on the facts of each case. An offer also lapses on the death or loss of contractual capacity, for example insanity, of either the offeror or the offeree before acceptance has been made, or where performance of the contract becomes illegal or impossible.

PRACTICALLY

SPEAKING

What name should you call your new business?

The name of your new business is a very important decision that can have a significant effect; however, there are limits as to what you can choose.

Firstly, the law may prevent you from choosing the name that you want. It may be too similar to the name of another business, or it may cause confusion or offence. Ultimately the name you choose should make sense to customers, and convey an image that is professional. The name of your business does not have to be descriptive of your products or services, but it can provide a useful opportunity for you to define your brand.

Some well-known names of businesses do not in any way resemble what it is that the business does. Shell does not sound like the name of a company that distributes oil and petrol products; Google is a made-up word. If you intend to offer a new product or service, it may be wise to select a name that does not confine you to what you currently do. Why limit your name to ‘Lucky's car spray’ if you could call your business ‘Lucky's repairs’? This will allow you to grow your business in other areas and still keep the same name. Changing a business name can be expensive and cause confusion amongst your customers.

Your business name must not be illegal: The name you select should never be offensive or rude, nor should it contain words or symbols that could cause confusion with other names or be too similar to words that are trademarked. If your business is not a registered company, it is illegal to use ‘Pty’ or ‘Limited’ in the name.

It may be useful to look at the telephone directory and search the internet for similar names before starting your business.

You should consider reserving the domain name: As more businesses trade online, it is a wise move to reserve an internet domain name and address for your new business as soon as possible. You may not want to create a website for your business when you first start, but reserving the name early on can help prevent a shock much later when you find out that someone else has reserved that name and has effectively locked you out of the internet.

If you do intend to trade on the internet, then you may find that the availability of domain names can influence or change your choice of business name. A few hundred rand will reserve the right name for your business, and will give you peace of mind for future growth of your business.

THIS CHAPTER IN ESSENCE

1. As a general rule, every contract or agreement is reducible to an offer and an acceptance. By looking at whether or not there was an acceptance of an offer, courts can decide if there was an agreement or not, and also where and when the agreement was entered into.
2. An offer is a proposal that expresses a person's willingness to become a party to a contract. Acceptance is the express or implied signification by the offeree of his or her intention to be bound contractually in terms of the offer made.
3. South African law follows the expedition theory for the acceptance of an offer, and the information theory for the revocation of an acceptance of an offer made by post. The reception theory applies to contracts accepted by fax, internet or e-mail.
4. A person seeking to impose special terms in a contract should take all reasonable steps to ensure that the other party is made aware of their existence. If the other party then sees and understands the terms, or knows of their existence, then he or she will be bound by them. The common law in this regard has been amended by the Consumer Protection Act in respect of certain transactions.
5. An offer may be made to a defined person, a group of persons, or the whole world.
6. The offer must be communicated to the offeree before it can be accepted.
7. The offer must have seriously been intended to create legal relations between the parties.
8. Acceptance of the offer must be absolute (unconditional), unambiguous, and correspond with the terms of the offer.
9. The offer and the acceptance must result in certain and definite terms.
10. Only the person to whom the offer is made may accept it.
11. Acceptance must be communicated to the offeror.

12. Acceptance must be made in the manner prescribed by the offeror.
13. Silence does not amount to acceptance.
14. An offer comes to an end on rejection, revocation, or lapse.

QUESTIONS

Short questions (1–5 marks)

1. Define offer.
2. Define acceptance.
3. At what time is a contract entered into if it is concluded by:
   a. Post.
   b. Telephone.
   c. E-mail.
4. Name five circumstances when an offer lapses.

Paragraph questions (5 marks)

1. Discuss four theories dealing with contracts concluded through the post.
2. Discuss how a contract may be entered into through the post, by telephone, and by fax.
3. Discuss the issues and problems of offer and acceptance that may arise when a reward is offered for information leading to the recovery of stolen property.
4. Discuss the doctrine of estoppel.

Essay questions (10 marks)

1. Discuss the rules of offer and acceptance.
2. Write notes on the introduction of special terms and conditions into a contract, for example tickets, receipts, and notices.

Problem questions (20 marks)

1. Zelda and Nico enter into a written contract in terms of which she sells her house to him for R100 000. The contract is valid and binding. The day after the contract was concluded Justin approaches Zelda and offers to buy the same house for R110

000. Zelda wants to accept the offer and tells Nico that she is not giving him the house. What is Nico's legal position?

2. Mrs Bates, who intends spending the night at a hotel, signs the register. At the top of the page is a term that exempts the hotel from liability for the loss of, or damage to, any property of any hotel guest. She does not read the clause and her attention is not specifically drawn to it. While she is at the cinema that night, her property is stolen from her hotel room. Discuss her legal position. Would her prospects of success in court be different if the hotel manager knew that she could not understand English?
3. Michael is shopping at a bookshop and decides to buy a book. Just as the cashier is about to ring up the sale, Michael decides that the book is too expensive and he tells the cashier he has changed his mind. Is Michael obliged to pay for the book?
4. Monty posts a letter in Cape Town, addressed to Basil in Johannesburg, in which Monty offers to sell to Basil three dozen bottles of a particular vintage wine for R30 000 cash. The same day, Basil (unaware of Monty's letter) posts in Johannesburg a letter to Monty in Cape Town, in which he offers to buy three dozen bottles of the same vintage wine for R20 000 cash. While the letters are in the post and neither Monty nor Basil is aware of the other's letter, Basil dies. The executor of his estate claims there is a valid contract. Monty denies this. Discuss.
5. Natalie claims R10 000 from Owen arising from an alleged contractual debt. Owen posts Natalie a cheque for R7 500 together with a letter stating that the amount is in ‘full and final settlement’ of Natalie's claim. Discuss.

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1 *Watermeyer v Murray* 1911 AD 61.

2 *Fern Gold Mining Company v Tobias* (1890) 3 SAR 134; *Odendaal v Norbert* 1973 (2) SA 749 (R); *Yates v Dalton* 1938 EDL 177.

3 *Collen v Rietfontein Engineering Works* 1948 (1) SA 413 (A); *Parsons v Langemann and others* 1948 (4) SA 258 (C) 147; *Axiam Holdings Ltd v Deloitte and Touche* [2005] 4 All SA 157 (SCA).

4 Sharrock, 228.

5 *Fram v Rimer* 1935 WLD 5; *Van der Merwe v Scheepers* 1946 TPD 147; *Hersch v Nel* 1948 (3) SA 686 (A).

6 *Hirschowitz v Moolman and others* 1985 (3) SA 739 (A).

7 Sharrock, 228.

8 Fouché, 49–50; Gibson 40–42.

9 *Cape Explosive Works v SA Oil and Fat Industries* 1921 CPD 224; *Kergeulen Sealing and Whaling Company v CIR* 1939 AD 487.

10 *Bal v Van Staden* 1907 TS 128.

11 *A to Z Bazaars (Pty) Ltd v Minister of Agriculture* 1975 (3) SA 460 (A).

12 *Tel Peda Investigation Bureau (Pty) Ltd v Van Zyl* 1965 (4) SA 475 (E); *S v Henckert* 1981 (3) SA 445 (A); Fouché, 51; Gibson, 41–42.

13 *S v Henckert* 1981 (3) SA 445 (A).

14 Electronic Communications and Transactions Act 25 of 2002; *Brinkibon Ltd v Stahag Stahj und Stahlwarenhandelsgesellschaft* [1982] 1 All ER 293, S Co.

15 *Roseveare v Auckland Park Sporting Club* 1907 TH 230; *Shepherd v Farrell's Estate Agency* 1921 TPD 62; Gibson, 42–43; Sharrock, 155–160.

16 *King's Car Hire (Pty) Ltd v Wakeling* 1970 (4) SA 640 (N); *Yeats v Hoffweg Motors* 1990 (4) SA 289 (NC).

17 Sharrock, 159–160.

18 *Davidson v Johannesburg Turf Club* 1904 TH 260.

19 *Central South African Railways v James* 1908 TS 221 at 226.

20 *Davis v Lockstone* 1921 AD 153.

21 *Olley v Marlborough Court Ltd* [1949] 1 KB 532 (CA), [1949] 1 All ER 127.

22 *Gabriel and another v Enchanted Bed and Breakfast CC* 2002 (6) SA 597 (C).

23 Consumer Protection Act 68 of 2008.

24 *Thornton v Shoe Lane Parking Ltd* [1971] 1 All ER 686 (CA); *Sun Couriers (Pty) Ltd v Kimberley Diamond Wholesalers* 2001 (3) SA 110 (NC).

25 *Central South African Railways v McLaren* 1903 TS 727.

26 *Chapelton v Barry Urban District Council* [1940] 1 KB 532 (CA), [1940] 1 All ER 356.

27 *Central South African Railways v McLaren* 1903 TS 727.

28 *Stocks and Stocks (Pty) Ltd v T J Daly and Sons (Pty) Ltd* 1979 (3) SA 754 (A) 762G–H.

29 *Chapelton v Barry Urban District Council* [1940] 1 KB 532 (CA), [1940] 1 All ER 356.

30 *Olley v Marlborough Court Ltd* [1949] 1 KB 532 (CA), [1949] 1 All ER 127.

31 *Roseveare v Auckland Park Sporting Club* 1907 TH 230; *Bok Clothing Manufacturers (Pty) Ltd v Lady Land (Pty) Ltd* 1982 (2) SA 565 (C).

32 *King's Car Hire (Pty) Ltd v Wakeling* 1970 (4) SA 640 (N).

33 *Yeats v Hoffweg Motors* 1990 (4) SA 289 (NC).

34 *Durban's Water Wonderland (Pty) Ltd v Botha and another* 1999 (1) SA 982 (SCA).

35 *Cape Group Construction (Pty) Limited t/a Forbes Waterproofing v The Government of the United Kingdom* 2003 (5) SA 182 (SCA).

36 Consumer Protection Act 68 of 2008.

37 Ibid.

38 Ibid.

39 Consumer Protection Act 68 of 2008.

40 Ibid.

41 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

42 Fouché, 45–47; Gibson, 31–48; Havenga et al., 50–52; Sharrock, 53–84.

43 *Hersch v Nel* 1948 (3) SA 686 (A); *Bird v Summerville and another* 1961 (3) SA 194 (AD).

44 *Bloom v American Swiss Watch Company* 1915 AD 100; *Bird v Summerville and another* 1961 (3) SA 194 (AD).

45 *Bloom v American Swiss Watch Company* 1915 AD 100.

46 Ibid.

47 *Carlill v Carbolic Smokeball Company* (1893) 1 QB 256 (CA).

48 *Crawley v Rex* 1909 TS 1105; *Efroiken v Simon* 1921 CPD 367; *Pitout v North Cape Livestock Co-operative Ltd* 1977 (4) SA 842 (A).

49 *Crawley v Rex* 1909 TS 1105.

50 *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd* [1953] 1 All ER 482 (CA).

51 Ibid.

52 *Neugebauer and Company Ltd v Hermann* 1923 AD 565.

53 Ibid.

54 Consumer Protection Act 68 of 2008.

55 *Carlill v Carbolic Smokeball Company* (1893) 1 QB 256 (CA).

56 *Lefkowitz v Geat Minneapolis Surplus Store* 251 Minn 188, 86 NW 2d 689 (1957).

57 *Watermeyer v Murray* 1911 AD 61; *Stephen v Pepler* 1921 EDL 70; *Boerne v Harris* 1949 (1) SA 793 (A); *Amalgamated Society of Woodworkers of SA v Schoeman NO* 1952 (3) SA 85 (T); *Van Jaarsveld v Ackerman* 1975 (2) SA 753 (A); *Westinghouse Brake and Equipment (Pty) Ltd v Bilger Engineering (Pty) Ltd* 1986 (2) SA 555 (A); *Ideal Fastener Corporation CC v Book Vision (Pty) Ltd t/a Colour Graphic* 2001 (3) SA 1028 (D).

58 *Amalgamated Society of Woodworkers of SA v Schoeman NO* 1952 (3) SA 85 (T).

59 *Watermeyer v Murray* 1911 AD 61.

60 Sharrock, 62.

61 *Illustrated London News*, 1893. Source: http://upload.wikimedia.org/wikipedia/commons/7/7e/Carbolic_smoke_ball_co.jpg, accessed 17 November 2011. This work is in the public domain due to its age.

62 *Boerne v Harris* 1949 (1) SA 793 (A).

63 *Mens Fair (Pty) Ltd v Bible Society of South Africa* 1976 (4) SA 12 (T).

64 *Humphries v Cassel* 1923 TPD 280; *Beretta v Beretta* 1924 TPD 60; *Schneier and London Ltd v Bennett* 1927 TPD 346; *Cassimjee v Cassimjee* 1947 (3) SA 701 (N); *Collen v Rietfontein Engineering Works* 1948 (1) SA 413 (A); *Roberts v Forsyth* 1948 (3) SA 926 (N).

65 *Coutts v Jacobs* 1927 EDL 120; Sharrock, 164.

66 *Service Motor Supplies (1956) (Pty) Ltd v Hyper Investments (Pty) Ltd* 1961 (4) SA 842 (A); *United Overseas Bank v Jiwani* [1977] 1 All ER 733 (QB).

67 *R v Nel* 1921 AD 39.

68 *Bird v Summerville and another* 1961 (3) SA 194 (AD).

69 Ibid.

70 *R v Nel* 1921 AD 39.

71 *Fern Gold Mining Company v Tobias* (1890) 3 SAR 134.

72 *Baker v Marshall and Edwards* 1913 WLD 156; *Ficksburg Transport (Pty) Ltd v Rautenbach en 'n ander* 1988 (1) SA 318 (A); Sharrock, 70.

73 *Eliason v Henshaw* (1819) 4 Wheaton 225 (US Supreme Court).

74 *Felthouse v Bindley* (1862) 11 CB (NS) 869.

75 Consumer Protection Act 68 of 2008.

76 Stadler, S, Unsolicited Goods and Services, *De Rebus*, Pretoria: Law Society of South Africa June 2010.

77 *Boyd v Nel* 1922 AD 414.

78 *Fern Gold Mining Company v Tobias* (1890) 3 SAR 134; *Greenberg v Wheatcroft* 1950 (2) PH A 56 (W).

79 *Yates v Dalton* 1938 EDL 177; *Odendaal v Norbert* 1973 (2) SA 749 (R).

80 *Yates v Dalton* 1938 EDL 177.

81 *Dietrichsen v Dietrichsen* 1911 TPD 486; *Laws v Rutherford* 1924 AD 261.

Chapter 11

Certainty of terms of contract

'Where the law is uncertain there is no law.'

PROVERB

What is covered in this chapter

1 Vagueness

2 Interpretation of contracts

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the fifth element of the definition of contract – the certainty of the terms of the contract.

Sometimes people simply do not express their intentions properly. Words can mean more than one thing, some terms may have been left out entirely, or it can be very unclear how performance of the contract will happen. In such cases the court may be required to interpret the contract to work out what arrangement the parties actually intended.

It is important that you understand the need for contracts to specify the terms so that the rights and duties of the parties are clearly understood. If the terms of contract are uncertain, it can be found to be void for vagueness.

1 Vagueness

The terms of the agreement must not be vague. The intention of the parties must be evident from the agreement. The three main types of uncertainty in agreements are as follows:[1]

- **Vague and indefinite language**: The court must be able to decide the obligations of the parties. For example, a term such as ‘payment of instalments on a regular basis’ has been held to be too uncertain because it did not specify when the payments would start, how much they would be, or how often they would be paid.[2]
- **Failure to agree on material provisions**: Sometimes the parties may not have expressed themselves properly and some terms could have been left out or not even considered at all. If the court is able to determine with reasonable certainty what the parties' intentions were, it will be able to enforce the agreement. The court may consider the relationship of the parties, the context in which the agreement was entered into, the conduct of both parties after the agreement was made, and any customs and practices applicable to that sort of agreement. For example, if a price is to be fixed by a specific third party, the contract will be enforced. However, if the third party is not identifiable, the contract will be void for vagueness.[3]
- **Grant to a party of unlimited choice whether to perform or not**: Where there is no firm undertaking to perform, the contract will be void for vagueness. For example, a term such as ‘payment of the purchase price in monthly instalments free of interest’ has been held to be too vague because it leaves it to the buyer alone to decide how many months to make payments, and the amount to be paid every month.[4] However, a promise to pay once a debtor has the financial ability to do so, has been held to be a question of fact and therefore not vague. A promise to pay at a rate of interest determined solely by the creditor has similarly been held not to be vague.

Banks have recently been faced with court actions because of contracts with their customers that allow them to unilaterally increase interest rates on loans from time to time. Our courts have held that these contracts are not uncertain because the power of the banks to change interest rates is not unlimited. The banks must have regard to objectively ascertainable criteria before changing interest rates, or they must in the normal course of business grant new loans at the same higher interest rate.[5]

2 Interpretation of contracts

The contract must not be so vague that the court is unable to work out what it means or what the intention is of the parties to the contract. As a general principle, the courts will try to ascertain on the evidence before them what the intention of the parties was at the time the contract was entered into.[6] This may be very difficult as the written contract may lend itself to several meanings and interpretations.[7]

2.1 Process of interpretation

When interpreting a written contract, the courts first look at the language used, then the circumstances in which the contract was made, and finally they apply particular rules of interpretation to help them understand the meaning intended by the parties.

The court will not contract for the parties; where the meaning cannot be worked out the contract will be void for vagueness. The intention must be gathered from the agreement as a whole.[8]

The first step in the process of working out the common intention of the parties is to apply the grammatical and ordinary meaning of the words used, unless this would result in some absurdity, repugnancy or inconsistency with the rest of the document.

- Words should be given their ordinary meanings, unless they are technical.
- The intention of the parties should be ascertained from the words used.[9]
- Written insertions should prevail over typewritten or printed words.
- Deletions are ignored completely. By the parties deleting a word they indicate that the deleted word should form no part of the agreement. Similarly, no inference will be drawn from the presence of the deleted word in any previous draft of the agreement.

The second step in the interpretation of contracts is that the words used should not be considered in isolation but in the context of the particular clause and the contract as a whole, bearing in mind the nature and purpose

of the contract. Because parties to contracts do not always use words in their usual, literal meaning, it is the context in which they are used that could indicate the particular meaning the parties had in mind.

- Evidence may be lead regarding the circumstances in which the contract was made, including the negotiations the parties had, and the parties' conduct.
- A preamble just serves to introduce the contract and should not be considered in interpreting what the rest of the contracts means.
- Ambiguities should be interpreted in favour of validating the contract.
- Ambiguities should be interpreted against the interests of the person who drew up the document. This is also known as the *contra preferentem* rule.[10]
- When construing an agreement comprising more than one document, one must consider all the terms used by the parties in all the documents to determine the meaning of the contract.[11]

The third step in the interpretation of contracts is for the courts to apply certain rules of construction, such as the assumption that the parties conducted themselves in good faith.

- Where words can be interpreted in more than one way, the courts will prefer an interpretation that favours the contract being valid rather than invalid.

2.2 The parol evidence rule

The ‘parol evidence rule’ is a rule of evidence also used by the court to work out the intention of the parties. This means that where the court is interpreting a written document, no oral evidence will be allowed if it contradicts or changes the written terms. Similarly, where the terms of a written contract are clear and unambiguous, no evidence may be given to vary their plain meaning.[12]

The exception is that in cases where ambiguous words are used, or where words are used in a technical or special sense, extrinsic evidence may be admissible to explain the broad context in which these words were used in the document.[13]

PRACTICALLY

SPEAKING

‘Boilerplate’ provisions in contracts

Most contracts contain essential ‘boilerplate’ or miscellaneous clauses that protect a business in the event of a lawsuit. These are the standard clauses that go on for pages and pages in typical contracts. Standard boilerplate clauses for any commercial contract include:

- **Attorney's fees provisions**: If a contractual dispute arises between the two parties, this clause ensures that the prevailing party recovers its attorney's fees and related costs.
- **Notices**: The parties may agree as to how and where communications can be sent. For example, will e-mail be allowed or must all correspondences be by post? What address must letters be sent to?
- **Entire agreement**: The entire agreement clause, which typically states that the contract is the final, complete, and total expression of the parties' agreement, helps prevent a party from claiming that there are other promises or terms to the deal that are not explicitly set forth in the written contract, such as oral representations, e-mails or memoranda, and other documents.
- **Consent to jurisdiction and forum selection**: This section establishes where any disputes between parties must be resolved. For example, if you are in Port Elizabeth, and the other party is in Durban, you will want the contract to say that all disputes may only be brought to and resolved in Port Elizabeth, which would make resolution of the dispute more convenient and cheaper for you.
- **Amendment of agreement**: To prevent someone from saying that the terms of the written agreement were verbally changed, the amendment of agreement clause should state that the contract may only be modified in writing and signed by all parties.
- **Ambiguities**: The ambiguities section is important if you are the drafter of the contract. There is a general principle of law that says ambiguities in a contract are construed against the drafter of the contract. An ambiguities clause would state that any ambiguous language in the contract shall be interpreted as to its fair meaning, and not strictly for or against either party.
- **Arbitration**: In the event of a dispute between the parties, this clause requires that the dispute be resolved by binding arbitration, not litigation. An arbitration clause must designate the binding nature of arbitration, the arbitrator, what arbitration rules must be followed, and where the arbitration will be held.
- **Assignment**: The assignment clause sets out the rights or prohibitions on the assignment of the contract. Typically, a contract is non-assignable, but if both parties agree to allow assignment under certain circumstances, the parties may transfer their interests to someone else.

There are other boilerplate clauses that may be appropriate for your particular business and situation. Consult your attorney to determine which clauses are relevant to your business and should be included in your commercial contracts.

THIS CHAPTER IN ESSENCE

1. The intention of the parties must be evident from the agreement.
2. The three main types of uncertainty in agreements are vague and indefinite language; failure to agree on material provisions; and granting a party unlimited choice whether to perform or not.
3. When working out the common intention of the parties, the courts first apply the grammatical and ordinary meaning of the words used, unless this would result in some absurdity, repugnancy or inconsistency with the rest of the document. Next, the words used should not be considered in isolation but in the context of the particular clause and the contract as a whole, bearing in mind the nature and purpose of the contract. Finally, the courts must apply rules of construction.
4. The parol evidence rule is a rule of evidence that may be used by the court to work out the intention of the parties. Where the court is interpreting a written document, no oral evidence is allowed if it contradicts or changes the written terms.

QUESTIONS

Short questions (1–5 marks)

1. List three types of uncertainty in agreements.
2. Define the parol evidence rule.

Paragraph question (5 marks)

1. Discuss the different types of uncertainty in contracts.

Essay question (10 marks)

1. Discuss how the courts go about interpreting a contract that has language that is vague or unclear.

Problem questions (20 marks)

1. Rasta signs a contract to buy a car from Happy, who has studied law and inserted some complicated clauses in the agreement:
    a. The car is described as a ‘passenger transportation device’.

b. The price is not mentioned, but can be decided by Happy in her sole discretion. The maximum price that can be charged is an amount of not more than the number of pages in the average Bible multiplied by the age of Happy's sister on her next birthday.
c. The contract is for Rasta to ‘purchase or lend or loan or obtain control’ of the ‘device’.
d. Delivery must be made at a date convenient to Happy.

Advise both parties.

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1 Sharrock, 85.

2 *Mitchell Cotts Freight Zimbabwe (Pty) Ltd v S and T Import and Export (Pvt) Ltd* 1982 (2) SA 669 (Z).

3 *Reymond v Abdulnabi* 1985 (3) SA 348 (W).

4 *Patel v Adam* 1977 (2) SA 653 (A).

5 *Standard Bank of SA Ltd v Friedman* 1999 (2) SA 456 (C); *ABSA Bank Ltd v Deeb and others* 1999 (2) SA 656 (N).

6 *De Beer v Keyser and others* 2002 (1) SA 827 (SCA).

7 Gibson, 48–49; Sharrock, 132, 173–178; Swanepoel et al., 53.

8 *Privest Employee Solutions (Pty) Ltd v Vital Distribution Solutions (Pty) Ltd* 2005 (5) SA 276 (SCA).

9 *Ferox Investments (Pty) Ltd v Blue Dot Nursery CC t/a Jasmine Plant and Bird Centre* [2006] 1 All SA 17 (O).

10 *Cairns (Pty) Ltd v Playdon and Company Ltd* 1948 (3) SA 99 (A).

11 *Privest Employee Solutions (Pty) Ltd v Vital Distribution Solutions (Pty) Ltd* [2006] 1 All SA 111 (SCA).

12 Sharrock, 176–177.

13 *Richter v Bloemfontein Town Council* 1922 AD 5.

Chapter 12

Reality of consent

'I know that you believe you understand what you think I said, but I'm not sure you realize that what you heard is not what I meant.'

ROBERT MCCLOSKEY (1914–2003)
AMERICAN AUTHOR AND ILLUSTRATOR OF CHILDREN'S BOOKS

What is covered in this chapter

1 Mistake
2 Misrepresentation
3 Duress
4 Undue influence
5 Statutory rights to fair and honest dealing
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the sixth element of the definition of contract – the requirement for there to have been real consent between the parties.

Certain types of mistake, misrepresentation, undue influence or duress can affect the reality of the consent that a party has given to a contract. If there is no genuine agreement and the contract does not represent a true meeting of the minds, it may be void or voidable. If it is voidable this means that it can be made void at the choice of the aggrieved party. For a detailed discussion on the differences between void and voidable contracts, see Table 6.2 in chapter 6 of this text.

It is important that you understand the situations that can result in a contract being void, as well as those situations that can lead to an aggrieved person choosing to make a contract void. This is because once a contract is void it is as if it never existed, and the parties must be restored back to the positions they were in before the agreement was entered into. This involves very different remedies to those available where a party breaches a contract – in that situation the contract continues to be in existence and typically an aggrieved party must be compensated as if the contract had been performed properly.

The common law provides remedies for contracts entered into through mistake, misrepresentation, duress or undue influence. Additional statutory protections and remedies may apply for certain transactions covered by the Consumer Protection Act.

1 Mistake

Mistake is a misapprehension of the existence or non-existence of a fact or a state of facts.[1] If all the requirements for mistake have been met, we say that the mistake is 'operative' and that the contract is void.[2] There are four types of mistake that are recognised by our law, but only one (mistake of fact) is regarded as ever being operative.

1.1 Mistake of law

In the absence of fraud, the general rule is that ignorance of the law excuses no one. Mistakes of law will not affect the validity of a contract.[3]

1.2 Mistake in expression

In the absence of fraud the general rule is, 'Let the signer beware'. The legal term for this phrase is *caveat subscriptor*. This means that a person who signs a written contract is deemed to have taken notice of its contents and is bound by its terms, whether he or she has read them or not.

> ***George v Fairmead (Pty) Ltd*** [4]
>
> A hotel guest signed the hotel register without reading an indemnity clause printed on it.
>
> The court held that he had chosen not to read it, and had therefore taken the risk of being bound by it.

Where the parties have signed a document that, owing to a mistake, does not reflect their common intentions, either party may apply to court for rectification of the document to reflect their common intention. As a result, a mistake in expression will not affect the validity of a contract. However, a contracting party is not allowed to snap up an offer that he or she knows or ought to know was made by mistake. One is not allowed to 'snatch at the bargain'. Courts will not enforce such a contract, for example where a price tag is accidentally marked with a ridiculously low amount. Likewise, the courts will not enforce a contract where one party ought reasonably to know

that the terms in the document do not reflect the true intentions of the other party.[5]

1.3 Mistake in motive

A mistake in motive will never affect the validity of a contract, because to give effect to it would destroy the sanctity of a commercial bargain. Simply because someone buys something for the wrong reason does not mean that he or she should be allowed to cancel the purchase.

1.4 Mistake of fact

This category of mistake is the only type of mistake that is ever operative in South African law, that is, it makes the contract void. A mistake of fact will only be operative if it is both reasonable and material.[6] This means the mistake must not be made carelessly and must be essential to the contract.

The mistake of fact could be of any of the following:

- The nature of the contract.[7] For example, the contract states it is one of sale whereas in fact it is a contract of lease.
- The identity of the subject matter of the contract.[8] For example, a contract for insurance of a motor vehicle states the wrong registration number and make of the vehicle.
- The attributes of the subject matter.[9] For example, a contract for the sale of a motor vehicle states that the vehicle had completed 20 000 km whereas in fact it had done 120 000 km.
- The identity of the parties to the contract.[10] For example, the name of one of the parties is spelled incorrectly, and there is no such person with that name.

There are three types of mistake of fact:

- **Common mistake of fact**: Both parties made the same mistake. If the mistake is material, the contract is void even if the mistake was not reasonable.[11]
- **Mutual mistake of fact**: Both parties made a different mistake. Here the parties are at cross-purposes. For example, one party thinks it is a

contract of sale and the other party thinks it is a donation, whereas in truth it is a contract of lease. The contract will be void only if the mistake is both material and reasonable.

- **Unilateral mistake of fact**: Only one party is mistaken. The error must be both material and reasonable to affect the validity of the contract.[12]

Payment or delivery of property made under a mistake of fact may be recovered by the aggrieved party through the ‘doctrine of unjustified enrichment’. The aggrieved party goes to court and shows how the other party has been unjustifiably enriched at his or her expense. The court may then order the return to the aggrieved party of the extent of the other's unjustified enrichment.

There are four requirements to prove liability for unjustified enrichment:

- The defendant must have been enriched.
- The plaintiff must have been impoverished.
- The defendant's enrichment must have been at the expense of the plaintiff.
- The enrichment must have been unjustified.

2 Misrepresentation

During negotiations, parties often make statements concerning the qualities of the goods or the terms of the contract. Sometimes these statements may be untrue. However, not every untrue statement will constitute misrepresentation.

There are three types of statement that may be made by one party to another in negotiating a contract:

- **Puff**: This merely boosts one's goods and is not intended to be taken seriously. It has no legal effect.[13] For example, ‘This car never needs petrol’.
- **Warranty**: A warranty is a statement that becomes a term of the contract and is enforceable. The maker of the statement actually undertakes that the statement will be complied with.[14] For example, ‘This car has never been in a collision’.

  A ‘guarantee’ is generally a form of warranty. The court will examine whether the statement was made in response to a direct question, and whether the party knew that the other party regarded the information as important. The party making it is obliged to comply with it and he or she will be in breach of contract if he or she does not.[15]

  A person making a warranty undertakes to make good what he or she is representing if it later turns out to be incorrect.[16] The remedies for a breach of warranty aim to place the aggrieved person in the position he or she should have been in if the representation had been true.
- **Representation**: This is a statement made by one party to another, before or at the time of contracting, that induces the contract but does not become a term of the contract. An erroneous opinion, therefore, is not a misrepresentation.[17] For example, ‘Everyone likes this car’.

  A representation merely intends to induce a party into a contract.

Misrepresentation is a false statement of fact made by one person to another, before or at the time of the contract, of some matter or circumstance relating to the contract, with the intention of inducing the

latter to contract, and that actually induces him or her to do so.[18] The remedies for misrepresentation aim to place the aggrieved person in the position he or she should have been in if the misrepresentation had not been made.[19]

There are three types of misrepresentation recognised by South African law: fraudulent, negligent and innocent misrepresentation.

2.1 Fraudulent misrepresentation

This is the representation of a false fact, made fraudulently, that was believed by the representee and was one of the factors inducing him or her to contract.

The representation of a false fact may be made either through an express statement (not a puff or mere opinion) or even by conduct:

- **Active concealment**: This refers to the failure to correct a false impression or half-truth.[20]

> ***Trotman v Edwick*** [21]
>
> A couple sold land with two flats on it. The land was enclosed by a wall. They never told the buyer that almost 30% of the land was in fact leased from the municipality for a nominal annual rental, and was meant to be a road in future. During the discussions, one of the sellers told the buyer to look at the two flats and 'look at the extent of the land … The house is built on quarter-acre plots and the frontage is about 150 feet.' He paced the frontage, including the municipal land, and said 'I make it roughly 150 feet'.
>
> The court held that by both his words and conduct he had misrepresented the extent of land being sold.

- **Designed concealment**: This refers to a situation in which a person purposefully conceals information he or she has a duty to disclose.[22]

> ***Dibley v Furter*** [23]
>
> The seller of a farm had taken steps to hide all traces of a graveyard near the house, and had then sold the farm to another without telling him about the graveyard.
>
> The court held the seller to be guilty of fraudulent misrepresentation.

Disclosure may be obligatory in the following situations:[24]

- The omission of facts has created a misleading impression.[25]
- A person has made a statement that is no longer correct because of a change in circumstances.[26]
- A person has effectively prevented the other contracting party from discovering the true state of affairs.[27]
- The proposed contract will require the parties to work in a relationship of trust and confidence with one another.
- Where the other party is involuntarily dependent on the frank disclosure of facts within that person's exclusive knowledge.[28]
- The law in respect of the particular contract requires disclosure, for example, the disclosure of a latent defect in a contract of sale, or of facts that are material to the risk in an insurance contract.

Fraudulent misrepresentation means that the representation was made without an honest belief in its truth, or with recklessness as to whether it was true or false.[29] It does not matter that a reasonable person would not have believed what was said.[30] The test is whether a reasonable person, once misled and accepting the truth of the misrepresentation, would have entered into the contract.[31]

Feinstein v Niggli and another [32]

The seller of shares in a restaurant made forecasts of the financial position to the buyer.

The court found that the forecast was exaggerated and that the seller didn't believe in his own figures. The buyer was entitled to cancel the contract based on the fraudulent misrepresentation.

The misrepresentation must be made with the intention of inducing the contract, and must have actually induced the contract being entered into.[33]

Bird v Murphy [34]

A man who had admired a distinctive luxury motor vehicle for a long time approached the owner to see if he could buy it. He had only a limited amount of money, and after several negotiations finally bought it for the price he could afford. During the negotiations the seller represented that the car was manufactured in 1957, whereas in fact it was really manufactured in 1953. After finding this out, he tried to rescind from the contract.

The court held that the representation had not induced him to enter into the contract.

South African law recognises four possible remedies for fraudulent misrepresentation:

- **Defence**: If the aggrieved party refuses to perform his or her side of the contract when he or she discovers the misrepresentation, and is then sued in terms of the contract, he or she may use the misrepresentation as a legal defence in the court case.
- **Specific performance**: The aggrieved party may enforce the contract (and claim damages in the form of money) to put him or her in the position he or she would have been in if the misrepresentation had never been made. These damages may take into account a reduction of the price to be paid, loss of profits, or even reimbursement for expenses unnecessarily incurred.[35]
- **Cancellation**: The aggrieved party may cancel the contract, claim all his or her performance back, and restore to the other party the extent of the other's performance. If the aggrieved party cancels the contract, he or she also must give back everything he or she has received in terms of the contract, and cannot refuse to do so.

  If what the aggrieved party received under the contract has perished or deteriorated because of a defect for which the other party is responsible, he or she needs to return only what remains. This restores both parties to their positions prior to the contract having been entered into.

  Where it is not physically possible to make exact restitution, the remedy will be limited to damages or a reduction in the price.[36]

  Hall-Thermotank Natal (Pty) Ltd v Hardman [37]

  Fraudulent misrepresentation was alleged by the owner of a fishing ship who had entered into a contract for the erection of a refrigeration plant. He wanted the cancellation of the contract and tendered the return of all property in his possession, claiming he was unable to return the remainder because the ship had sunk in a storm.

  The court held that his inability to make restitution could be excused if it was not due to his own fault.

- **Delictual damages**: Whether the aggrieved party chooses to enforce the contract or cancel it, he or she may have an additional remedy based on the fact that fraud is a delict. Therefore, delictual damages may also be

claimed, for example the cost of preserving the subject matter, re-delivering it, expenses incurred in testing it, or consequential losses incurred as a result of the fraud.[38]

2.2 Negligent misrepresentation

This is the representation of a false fact, made negligently, which was believed by the representee and which was one of the factors inducing him or her to contract.

South African law recognises three possible remedies for negligent misrepresentation:

- **Defence**: The aggrieved party may use the misrepresentation as a defence in court if sued by the other party.
- **Specific performance**: The aggrieved party may enforce the contract and claim damages in the form of money to put him or her in the position he or she would have been in had the misrepresentation never been made.
- **Cancellation**: The aggrieved party may cancel the contract and claim all his or her performance back.

Despite the fact that negligence is a delict, there are conflicting court decisions on whether or not the aggrieved party may claim delictual damages such as consequential losses as a result of the negligence.[39]

2.3 Innocent misrepresentation

This is the representation of a false fact made innocently, which was believed by the representee and was one of the factors inducing him or her to contract.

South African law recognises two possible remedies to innocent misrepresentation:

- **Defence**: The aggrieved party may use the misrepresentation as a defence in court if sued by the other party.
- **Cancellation**: The aggrieved party may cancel the contract and claim restitution.

Table 12.1 *Remedies for misrepresentation*

	Fraudulent misrepresentation	**Negligent misrepresentation**	**Innocent misrepresentation**
Defence if sued	Yes.	Yes.	Yes.
Specific performance	Yes, plus damages to restore the aggrieved person to the position they would have been in had the misrepresentation never been made.	Yes, plus damages to restore the aggrieved person to the position they would have been in had the misrepresentation never been made.	No.
Cancellation	Yes, claim full performance back, plus restore to the other party everything that person has given.	Yes, claim full performance back, plus restore to the other party everything that person has given.	Yes, claim full performance back, plus restore to the other party everything that person has given.
Delictual damages	Yes, costs and expenses incurred as a result of the fraud.	Not clear. There are conflicting court decisions on this point.	No.

3 Duress

Duress is a situation in which a person suing was induced by violence, threat, or fear to enter into a contract.[40] Where this force was so great that no reasonable person could have resisted it, the law deems that there could have been no true meeting of the minds. The effect is that the contract is voidable at the choice of the aggrieved party.[41]

The aggrieved party must establish the following three essential elements to prove duress:

- There must have been a reasonable and substantial fear of imminent harm to the plaintiff's life, person, or dignity, or to that of his or her family. Where property is threatened, the court requires proof that the victim protested when entering into the contract.[42]
- The threat must be illegal or must have involved the use of legal means to achieve an illegal result.
- The pressure must have caused the plaintiff to agree. It must be shown that the contract would not have been entered into had there been no duress.[43]

> ***Broodryk v Smuts NO*** [44]
>
> A road worker employed by the government claimed that he had entered into a contract to enlist in the armed forces under the threat that he would otherwise be imprisoned or interned. The threat had been made by two government officials authorised to enlist people for military service.
>
> The court found the contract to be voidable by reason of duress.

The principle of economic duress has not yet been authoritatively accepted in our law. This is the situation where someone enters into a contract because they fear financial ruin if they do not.[45]

> ***Medscheme Holdings (Pty) Ltd and another v Bhamjee*** [46]
>
> A doctor signed two acknowledgements of debt for the repayment of money he had been paid previously by some medical aid schemes. He later alleged that he had signed under duress, after being told that unless he signed them the system of direct payment to him would be stopped. This would have had serious financial consequences for him.

The court held that the principle of economic duress had yet to be authoritatively accepted in our law. It was neither unlawful nor unconscionable to cause economic ruin to another. Hard bargaining was not equivalent to duress, even where the bargain was the product of an imbalance in bargaining power. The economic bargaining would have to be found to be illegitimate or unconscionable for there to have been duress.

4 Undue influence

Undue influence is the weakening of a person's resistance in order to make his or her will pliable.[47]

The influence must be exerted in an unprincipled manner to obtain consent to an inherently prejudicial transaction, which would otherwise never have been entered into had the person had normal freedom of will.[48]

The contract will be voidable if the aggrieved party acts reasonably soon after the influence is removed. Undue influence is easier to prove where there is a special relationship between the parties, such as between attorney and client, doctor and patient, parent and child, or religious minister and member of a congregation.[49]

Preller v Jordaan [50]

The doctor of an ill patient took transfer of various properties. The patient recovered and claimed that he had been mentally and physically exhausted from illness, and that if it had not been for the undue influence, he would never had agreed to the transfers.

The court found that such a reason could be sufficient for cancellation of the contract.

5 Statutory rights to fair and honest dealing

If a contract is a transaction protected under the Consumer Protection Act,[51] then the following statutory protections may also apply:

5.1 Unconscionable conduct

A seller must not use physical force against a buyer, or coercion, undue influence, pressure, duress, harassment or unfair tactics, with regard to marketing, supply, negotiation or enforcement of an agreement, demand for payment or recovery of goods.

In addition it is unconscionable for a seller knowingly to take advantage of the fact that a buyer was substantially unable to protect his or her own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor.

5.2 False, misleading or deceptive representations

A seller is not allowed by words or conduct to directly or indirectly express or imply a false, misleading or deceptive representation concerning a material fact to a buyer. Nor may he or she exaggerate or fail to disclose a material fact if that failure amounts to a deception. The seller must also correct any apparent misapprehension on the part of the buyer.

The following are examples of false, misleading or deceptive representations that may be prohibited by the Act:

- The seller of goods or services has a status or connection or sponsorship it actually does not have.
- Goods or services have ingredients or performance or approval they do not have; are of a particular standard, grade or model they are not; are new if they are actually used; been used for a period materially different from the time claimed; are the same as those previously supplied when

this is not the case; or they are available for delivery within a specific time when they cannot be.
- Land has characteristics it does not actually have; may lawfully be used for purposes which are actually not legal; or is close to facilities or resources when it is not.
- Necessary maintenance or parts are available when they are not.
- Any service or part is needed when it is not.
- A charge is for a specific purpose when it is not.
- An employee or agent has the necessary authority to enter into an agreement when they do not.
- The transaction does not affect a consumer's rights when it does.
- The buyer will benefit by providing a new customer to the seller, when he or she will not.

The fact that a seller breaches the Act does not make the contract with the buyer void or voidable. It remains valid; however, the seller may be fined up to the greater of ten per cent of the annual turnover of the business or R1 million. Employers can be held vicariously liable to pay the fines in respect of the conduct of their employees.

The courts can also impose penalties for offences. Generally the penalty for an offence may be up to 12 months imprisonment.

PRACTICALLY SPEAKING

Some tips for choosing the right domain name for your business

- The most popular domain names will end in .com and .za, but there are also others to consider, such as .org or .net.
- It is not always important to choose a name that describes your business – some of the most memorable domain names are entirely unrelated to what the business does and have become brands in their own right. Think, for example, of Apple and Google.
- Be careful in the name that you select. You do not want to limit the type of business you do in the future. Your business may specialise now in repairing a specific make of motor vehicle, but you may expand your business in future to do all sorts of repairs. This means that 'Wefixanything.co.za' might be a better choice than 'Wefixcars.co.za'.
- Marketing experts recommend that the domain name should be short so as to be easier to remember. Try to avoid a domain name that is very long.
- These days the success of a business may depend on how often it appears in search engines such as Google. For this reason some have thought it may help if major

search words and terms are included in the domain name. This trick has been recognised by the engineer who program the search engines, and so its effect is not very effective any more.

- Some characters may not be used in domain names; you may use alphabet letters and numbers, but no other symbols should be used.
- Reserve your domain name and renew it as often as necessary. Make sure that the internet company you use is established and reputable.
- Sometimes you may want to reserve names similar to that of your business to prevent others from using those names and competing against you.
- Avoid using domain names that are trademarked or that may confuse consumers.

THIS CHAPTER IN ESSENCE

1. Mistake is a misapprehension of the existence or non-existence of a fact or a state of facts.
2. A mistake of fact could relate to the nature of the contract, the identity of the subject matter of the contract, the attributes of the subject matter, or to the identity of the parties to the contract.
3. A mistake of fact may be common, mutual or unilateral.
4. If mistake is operative, the contract is void. Payment or delivery of property made under a mistake of fact may be recovered by the aggrieved party through the doctrine of unjustified enrichment.
5. A representation is a statement made by one party to another, before or at the time of contracting, that induces the contract but does not become a term of the contract. Fraudulent misrepresentation means that the representation was made without an honest belief in its truth, or with recklessness as to whether it was true or false. Misrepresentation can also be negligent or innocent.
6. A contract entered into through misrepresentation is voidable. An aggrieved party can cancel a contact induced by any form of misrepresentation, but may only claim specific performance for fraudulent or negligent misrepresentation.
7. Duress is a situation in which a person suing was induced by violence, threat, or fear to enter into a contract. A contract entered into through duress is void.
8. Undue influence is the weakening of a person's resistance in order to make his or her will pliable. A contract entered into through undue influence is voidable.
9. The Consumer Protection Act prohibits unconscionable conduct with regard to certain buying and selling transactions. The statute does not make any such contract void or voidable; the seller is liable to a criminal conviction including a fine or imprisonment.

QUESTIONS

Short questions (1–5 marks)

1. List four types of mistake.
2. Name the requirements to be satisfied before a mistake will make a contract void.
3. Define misrepresentation.
4. What are the differences between ‘active concealment’ and ‘designed concealment’?
5. List the essential elements for duress.
6. Define undue influence.
7. What does ‘specific performance’ mean?

Paragraph questions (5 marks)

1. Write notes on the forms of relief granted in cases of innocent misrepresentation.
2. Write notes on the forms of relief granted in cases of negligent misrepresentation.
3. Write notes on the forms of relief granted in cases of fraudulent misrepresentation.
4. What is meant by: ‘Let the signer beware’?
5. What is the role of the Consumer Protection Act in preventing unconscionable conduct?

Essay question (10 marks)

1. Distinguish between mistake and misrepresentation and discuss the effect each has on the validity of a contract.

Problem questions (20 marks)

1. Peter sells his plot to John. When John made the offer to purchase the land, he made it clear that he wanted to buy the property to cultivate flowers and that he would need sufficient water for this purpose. Although Peter knew that this was untrue, he told John that there was plenty of underground water, as well as municipal water. When John takes possession of the property, he finds out there is very little water on the property. What is John's legal position?
2. While negotiating the sale of his farm, Sipho tells Benny the total turnover and profits for the past three years. This creates the

impression that buying the farm is a good business decision. A breakdown of the figures would reveal, however, a steady decline in profits each year. After buying the farm, Benny discovers the situation and comes to you for advice.

3. Desmond wants to buy Elizabeth's television set. Although Elizabeth knows that the television is 20 years old and does not function properly, she tells Desmond that it is practically new and that it performs excellently. Based on what she tells him, Desmond buys the television set. Advise him of his legal position.
4. Colin sells a fruit farm to David. During the negotiations, Colin told David that there were 800 000 fruit trees on the farm. After David buys the farm, he finds out that there are only 750 000 fruit trees. Although Colin truly believed that there were 800 000 fruit trees, it would have been easy for David to establish the truth. Discuss the legal positions of the parties.
5. Aaron inspects several motor vehicles that are for sale. All the vehicles belong to Bert. Aaron decides to buy the 1989 Ford that he has test driven. He says to Bert, ‘I offer to pay R10 000 for the Ford’. He is not aware that Bert has five Fords for sale. Bert accepts the offer, but he has the 1988 model in mind. Advise Aaron and Bert.

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1 Kahn, 85.

2 Fouché, 56–58; Gibson, 52–56; Havenga et al., 55–58; Sharrock, 72–79; Swanepoel et al., 30–32.

3 *Rooth v The State* (1888) 2 SAR 259; *Sampson v Union and Rhodesia Wholesale Ltd (in liquidation)* 1929 AD 468.

4 *George v Fairmead (Pty) Ltd* 1958 (2) SA 465 (A).

5 *Horty Investments (Pty) Ltd v Interior Accoustics (Pty) Ltd* 1984 (3) SA 537 (W).

6 *Papadopoulos v Trans-State Properties and Investments Ltd* 1979 (1) SA 682 (W); *Du Toit v Atkinson's Motors Bpk* 1985 (2) SA 893 (A); *Kempston Hire (Pty) Ltd v Snyman* 1988 (4) SA 465 (T).

7 *Dobbs v Verran* 1923 EDL 177.

8 *Maritz v Pratley* (1894) 11 SC 345.

9 *Trollip v Jordaan* 1961 (1) SA 238 (A).

10 *National and Overseas Distributors Corporation (Pty) Ltd v Potato Board* 1958 (2) SA 473 (A).

11 *Dickinson Motors (Pty) Ltd v Oberholzer* 1952 (1) SA 443 (A).

12 *George v Fairmead (Pty) Ltd* 1958 (2) SA 465 (A).

13 Sharrock, 125–126.

14 Sharrock, 204–205.

15 *Petit v Abrahamson* 1946 NPD 673.

16 Sharrock, 205.

17 *Lamb v Walters* 1928 AD 358.

18 Fouché, 60–64; Gibson, 66–74; Havenga et al., 58–60; Kahn, *Contract and Mercantile Law through the Cases*, 112; Sharrock, 120; Swanepoel et al., 33–35.

19 Sharrock, 121–122.

20 Sharrock, 122–123.

21 *Trotman v Edwick* 1951 (1) SA 443 (A).

22 *Dibley v Furter* 1951 (4) SA 73 (C).

23 Ibid.

24 Sharrock, 121–123.

25 *Marais v Edelman* 1934 CPD 212.

26 *Cloete v Smithfield Hotel (Pty) Ltd* 1955 (2) SA 622 (O).

27 *Dibley v Furter* 1951 (4) SA 73 (C).

28 *Pretorius v Natal South Sea Investment Trust Ltd* 1965 (3) SA 410 (W).

29 *Collen v Rietfontein Engineering Works* 1948 (1) SA 413 (A); *Parsons v Langemann and others* 1948 (4) SA 258 (C) 263.

30 Sharrock, 125.

31 *Otto v Heymans* 1971 (4) SA 148 (T).

32 *Feinstein v Niggli and another* 1981 (2) SA 684 (A), Fouché, 62; Gibson, 40–42.

33 Sharrock, 124–125.

34 *Bird v Murphy* 1963 (2) PH A42 (D).

35 *Bal v Van Staden* 1907 TS 128.

36 *SA Oil and Fat Industries Ltd v Park Rynie Whaling Co* 1916 AD 412; *Uni-Erections v Continental Engineering Co Ltd* 1981 (1) SA 240 (W); *Harper v Webster* 1956 (2) SA 495 (FC).

37 *Hall-Thermotank Natal (Pty) Ltd v Hardman* 1968 (4) SA 818 (D).

38 *A to Z Bazaars (Pty) Ltd v Minister of Agriculture* 1975 (3) SA 460 (A); Sharrock, 131–134.

39 *Greenfield Engineering Works (Pty) Ltd v NKR Construction (Pty) Ltd* 1978 (4) SA 901 (N); *Administrateur Natal v Trust Bank van Afrika Bpk* 1979 (3) SA 824 (A); *Kern Trust (Edms) Bpk v Hurter* 1981 (3) 607 (C).

40 Kahn, *Contract and Mercantile Law through the Cases*,14; Sharrock, 126–128.

41 Fouché, 64; Gibson, 74–76; Havenga et al., 60; Sharrock, 127; Swanepoel et al., 35–36.

42 *Hendricks v Barnett* 1975 (1) SA 765 (N).

43 *Broodryk v Smuts NO* 1942 TPD 47.

44 Ibid.

45 *Medscheme Holdings (Pty) Ltd and another v Bhamjee* 2005 (5) SA 339 (SCA).

46 Ibid.

47 Kahn, *Contract and Mercantile Law through the Cases*, 142.

48 Fouché, 65; Gibson,76–77; Havenga et al., 60–61; Sharrock, 128–129; Swanepoel et al., 36.

49 *Preller v Jordaan* 1956 (1) SA 483 (A).

50 Ibid.

51 Consumer Protection Act 68 of 2008.

Chapter 13

Possibility of performance

'Do or do not … there is no try.'

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What is covered in this chapter

1 Possibility

2 Types of impossibility

3 Enforcement of illegal contracts

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

This chapter covers the seventh element of the definition of a contract – the possibility of performance of the contract.

What are your rights if you enter into a contract that is impossible to perform? Or that becomes impossible to perform, after you have entered into it? Strange as it may seem, this situation happens all the time. People contract to do things and then fall ill and cannot; objects that are sold are destroyed before they get delivered; laws are changed to prohibit an arrangement that was previously legal.

Our law has developed tests to work out when parties can validly claim that they are not able to perform a contract because of impossibility. It is important that you understand and can apply these tests so that you know when impossibility can properly be claimed, and when not.

1 Possibility

A contract must be physically and legally capable of being performed. A contract will be void where it was impossible to perform it at the time it was entered into. A contract may be voidable where performance becomes impossible only after the contract was entered into.[1]

For a person to escape liability for a contract due to impossibility, he or she must prove to the court the following four elements relating to the impossibility:

- The impossibility of performance must have been due to either an act of God or an unavoidable situation beyond the control of the parties: Natural disasters are sometimes called ‘acts of God’ or *vis major*. For example, earthquakes, fires or floods. Examples of unavoidable situations beyond the parties' control include government actions, changes in law, or death or disease; such unavoidable situations are also known as *casus fortuitus*.[2]
- The impossibility must be absolute: There must be no way that the contract could possibly be performed by any person. If anyone else could have performed the contract, the court will not recognise that performance was impossible.[3]
- The person claiming impossibility must not be responsible for the impossibility.[4] You cannot sabotage the contract and then claim it was impossible.
- The impossibility of performance must not have been foreseeable: By contrast, a ‘speculative contract’ foresees the possibility of failure and inability to perform. For example, a farming contract foresees the possibility of drought.[5]

2 Types of impossibility

South African law recognises two categories of impossibility: physical impossibility and legal impossibility.[6]

2.1 Physical impossibility

There can be no contract if the contract was not physically capable of being performed when the contract was first made. For example, if a contract to buy an artwork is entered into on the same day that the artwork is destroyed by a fire.

Contracts are void if performance is objectively impossible when the contract is entered into. The contract may be voidable if performance only becomes impossible after the contract was entered into.

2.1.1 Objective impossibility

If the contract is impossible for anyone in the world to perform, it is void and we say that it is ‘objectively impossible’.

The contract is ‘subjectively impossible’ when it is only the contracting party who cannot perform it. Subjective impossibility does not make the contract void, even if the impossibility was specifically foreseen by one of the parties.

2.1.2 Supervening impossibility

A contract will be void if it becomes impossible to perform due to an act of God or an unavoidable situation beyond the control of either party.

The contract will be valid, however, if the impossibility arose due to the deliberate or negligent conduct of one of the parties.

Peters, Flamman and Company v Kokstad Municipality [7]

A partnership contracted with the municipality to supply gas light to the town. The partners were then jailed as enemy subjects, and the gas supply was cut off.

The court held that the contract had become impossible to perform after being entered into. Where an individual was prevented from performing by an act of State he is discharged from all liability.

Orda AG v Nuclear Fuels Corporation of South Africa (Pty) Limited [8]

A transaction relating to the sale of uranium was subject to ministerial consent.

In this case performance of the contract had become impossible because ministerial consent had not been obtained. However, the court held that although performance had become impossible this did not necessarily relieve the defendant of its obligations.

The general rule that obligations are extinguished when impossibility supervenes does not apply where the causes of impossibility are in the contemplation of the parties. The defendant had taken upon itself the obligation to obtain the required ministerial consent, and had accordingly assumed the risk of supervening impossibility.

Must the supervening impossibility be permanent? The issue is whether the temporary supervening impossibility of performance of one of the parties has the effect of discharging that party's duty to perform under the contract.

World Leisure Holidays (Pty) Ltd v Georges [9]

The court was asked to consider the effect of temporary supervening impossibility of performance on the obligations of the parties under a contract.

A tour operator sold package tours to Mauritius. Georges booked a holiday and paid the full cost in advance. A cyclone hit the island the night before the departure and SAA cancelled all flights for a day. An alternative flight to Mauritius was arranged for two days later, but Georges decided to cancel his trip and demanded a refund of the money he paid. His claim was based on breach of contract; alternatively, that performance by the tour group had become impossible.

The court held that there was no question of breach of contract that could have entitled Georges to cancel the contract. The tour operator's obligation to perform under the contract was suspended for the period during which the impossibility continued. Temporary supervening impossibility of performance does not of itself terminate the contract.

2.2 Legal impossibility

For a contract to be valid and enforceable, it must not be illegal, immoral, or contrary to public policy.

Just because a law is broken does not necessarily mean that a contract is invalid; it is all a question of construction of the statute, that is, the court must work out the intention of Parliament when it passed the law in the first place.

In addition, simply because a contract is not void does not mean that the courts will enforce it.[10]

2.2.1 Types of legal impossibility relating to

contracts

There are three types of agreements that may be legally impossible: agreements to commit crimes or delicts, or break the law; agreements contrary to public policy; and agreements in restraint of trade.

2.2.1.1 Agreements to commit crimes or delicts, or break the law

These agreements are void in terms of the common law. Agreements to injure the State, obstruct the course of justice, or defraud the public are also void.

Lion Match Company Ltd v Wessels[11]

The parties had contracted to sell wood, and had not obtained the necessary government permit. The contract was held to be void.

2.2.1.2 Agreements contrary to public policy (against good morals)

Contracts that are against public policy are valid, but will not be enforced by the courts because they are against good morals. These include wagering contracts and agreements to sell the inheritances of people who are still alive. For example, a bet is a contract by A to pay money to B on the happening of a given event, in consideration of B paying money to A if the event does not happen.

Even though gambling may be legal in South Africa under certain circumstances, the courts still view wagering contracts as unenforceable because they are regarded as being against public morality. There can generally be no court action by a winner for his or her winnings, and the loser cannot be taken to court for what he or she has lost. Under the common law, even a subsequent written contract to pay a lost bet is unenforceable in court.[12]

2.2.1.3 Agreements in restraint of trade

These are agreements in which a person agrees to a future limitation on his or her trade or work.

In deciding whether or not to enforce a restraint of trade, a court considers two conflicting principles: Should a person be allowed to trade

when and how he or she likes (freedom of trade) or should a person be bound to the contract he or she agreed to (sanctity of contract)?

Previously, the general principle was that public policy requires that every person be free to carry on his or her trade and earn a living as he or she pleases. All interferences with individual liberty of action in trading and all restraints of trade were contrary to public policy and therefore void.[13]

South African law has changed and now recognises that restraints of trade may be justified.

***Magna Alloys and Research (SA) (Pty) Ltd v Ellis*[14]**

The court held that agreements in restraint of trade firstly had to be viewed as being valid. It was then up to the person being restrained to show that it would be unreasonable and against public policy to enforce the restraint. This meant that there was no need for the person who wanted to enforce a restraint to prove that the restraint was reasonable. The only test was whether the restraint would be harmful to public policy to enforce it, and the need to prove that rested on the party who refused to comply with a restraint to which he or she had previously agreed.

The current position is that our courts will find restraints of trade to be valid and enforceable until they are proven unreasonable. When a person alleges that he or she is not bound to a restraint to which he or she agreed in a contract, that person must prove that enforcement of the restraint will be against public policy and the public interest. The court will consider the circumstances at the time of the request to enforce the restraint.

The courts may find part of the restraint, or the entire restraint, to be enforceable or unenforceable.[15] The courts can disregard the separate corporate personality of a close corporation or company where a natural person, who is subject to a restraint of trade, uses a corporate identity as a front to violate the restraint.[16]

Restraints of trade are very common and fall into two categories:

- **Between persons on an equal footing**: A good example of this type of restraint is between a buyer and the seller of the ‘goodwill’ of a business, which restrains the seller from competing with the buyer for a period of time after the business has been sold. A buyer of goodwill is entitled to protection from the seller's competition, otherwise he or she would not get what was paid for. This type of restraint will be valid if it

is reasonable, that is, no wider in scope, time, and geographical area than is reasonably required.

What is reasonable depends on the circumstances of each case. Since the parties are on an equal footing when bargaining, the courts regard them as the best judges of their requirements. The mere existence of an agreement is strong evidence that its terms are reasonable between the parties.[17]

- **Between persons on an unequal footing**: For example, between an employer restraining an employee from working for a rival employer, or from opening a similar business in competition with the employer after leaving employment.

  These contracts are very common if the employee is highly skilled. Our courts used to accept the view that the employee is generally in an inferior bargaining position to the employer. Because a restraint may deprive a person of his or her ability to earn a living, the courts were very reluctant in these cases to find restraints valid. In more recent cases, however, judges have said that whether or not an employee is in an inferior bargaining position is a matter of fact to be determined in each case. In situations where the employee is highly trained or skilled he or she may have the superior bargaining position.

The courts distinguish between two types of knowledge when considering restraints of trade in the employment context:

- **Subjective knowledge**: The employee's mental and manual skill and dexterity are his or her own property, even though they were acquired in the course of employment. He or she cannot be restrained from using them.[18]
- **Objective knowledge**: Influence over an employer's customers and knowledge of trade secrets are considered property belonging to the employer. The employee can be restrained from using the employer's property for his or her own purposes.[19]

In deciding whether to uphold a restraint, the court will consider whether the employment was of a type in which the employee was likely to acquire objective knowledge, and whether the restraint was no wider than reasonably required to protect the employer from an illegitimate use of this

knowledge. The court may refuse to enforce a restraint of trade unless it is reasonable under the particular circumstances.[20]

Where there is a valid agreement in restraint of trade, the courts will interdict a party from breaking it. Damages also may be claimed if that party has already broken the restraint.

Where an agreement in restraint of trade is invalid because it covers too wide a scope, time, or geographical area, the courts will not cut it down to a reasonable scope, time, or area, because this would be to make an agreement for the parties. This is not the court's function. The court will simply make the whole restraint void.

However, if the unreasonable part of the restraint can be removed, the court may decide that the remainder is enforced.[21] Where the restraint clause forms part of a wider agreement (for example the sale of a business), an invalid restraint will not cause the whole agreement to fall away if it can be removed, or altered, in such a way that the wider agreement can be made reasonable.[22]

The removal or alteration of the unlawful part must leave the essential nature of the contract unaffected. If severance or alteration is impossible, the whole contract is void. The court will normally only sever an invalid or illegal term from an agreement if the parties would have still entered into the contract without it, even though this may have been on different terms.

2.2.1.4 The future of restraints of trade

Our society's constitutional norms are based on freedom of competition and trade. This means that any interpretation of agreements in restraint of trade must be viewed in that light.[23] In exercising freedom of trade, individuals may enter into any kind of arrangement, even if this restricts the fundamental right. However, any restrictions imposed must be justified.[24]

Section 22 of the Constitution[25] provides that ‘every citizen has the right to choose their trade, occupation, or profession freely. The practice of a trade, occupation, or profession may be regulated by law’. In terms of section 36(1) this right can be ‘limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality, and freedom’.

Some court decisions have indicated that restraints of trade are consistent with the Constitution, and that there is no need to re-evaluate the principle of sanctity of contract. Other suggest that restraints of trade should not be enforced because they harm the economy and prevent a person from earning a living or setting up a business of his or her own. The law governing restraints of trade has historically had to deal with the tension between these two policy factors.[26] However, it is now settled law that restraints of trade are enforceable unless the person wishing to escape a restraint proves it to be unreasonable and therefore contrary to public policy.[27]

3 Enforcement of illegal contracts

Performance under a contract must be legal. Where performance is illegal or immoral, the court will examine the relative positions of the parties to decide if any remedy should be allowed.

The courts use the following two rules to assist them in deciding whether to allow a remedy for performance made under an illegal contract:

- **From an illegal cause no action arises**: The Latin expression for this rule is *ex turpi causa non oritur actio*. This rule is also sometimes known as the *ex turpi causa* rule. The effect of this rule is that an illegal contract can never be enforced, irrespective of whether the plaintiff knew of the illegality. There is nothing to enforce because the agreement is void. The remedy is that the party who has performed should be able to recover his or her performance on the basis of unjustified enrichment.[28]
- **In equal guilt the position of the possessor is stronger**: The Latin expression for this rule is *in pari delicto potior est condictio possidentis*. This rule is also sometimes known as the *par delictum* rule. This rule covers the situation where both contracting parties are equally at fault. For example, they both knowingly entered into a contract that is against public policy. Where one party has performed and the other has not, the performing party cannot claim back what he or she has paid to, given to, or done for, the other party. The law says that the position of the possessor is stronger. Hence the saying, 'Possession is nine-tenths of the law'. This means that the court will not enforce a void contract and will not grant the common-law remedy of unjustified enrichment.

  The effect of this rule is that a party who is at least as guilty as the other party and who has performed under the agreement will not be able to recover his or her performance.[29]

  This rule can obviously cause hardship. The Supreme Court of Appeal of the High Court has expressly disapproved of its strict enforcement, and held that the 'In equal guilt' rule will be relaxed where this is necessary 'to do simple justice between man and man'.[30] In analysing the facts of each case, the court will consider whether the

remedy would have been granted if the contract had been legal, and whether one party would be unjustifiably enriched at the expense of the other if the remedy was not allowed. Public policy considerations will also apply, and the court is unlikely to grant any relaxation of the 'In equal guilt' rule if the agreement is particularly offensive to public policy.

Jajbhay v Cassim [31]

A landlord illegally let a property to another person in violation of the local regulations. The tenant complied with the terms of the lease in every respect. The landlord applied to court for an order of ejectment based on the illegality of the tenancy. The court held that while the 'In equal guilt' rule could be relaxed to prevent injustice or to satisfy the requirements of public policy, no such rationale applied in the particular case.

Petersen v Jajbhay [32]

A tenant had illegally sublet a property in an area reserved for persons of another race group. The tenant was liable for immediate ejectment if he failed to pay the rent in advance. The court relaxed the 'In equal guilt' rule and granted an order of ejectment.

Kylie v CCMA and others [33]

A sex worker was dismissed from a massage parlour without a hearing. She referred the matter to the CCMA, which held that because she was involved in illegal work as a prostitute it had no jurisdiction to hear the matter.

On appeal, the Labour Appeal Court held that the CCMA did have jurisdiction to determine the dispute. However, if she won the case she would not be entitled to reinstatement or re-employment as that would be enforcing an illegal employment relationship. Similarly she could not be given compensation for her substantively unfair dismissal. However, the court could award monetary compensation for the loss of her right to a fair procedure because that kind of compensation was independent of the loss of illegal employment and could be applicable in an appropriate case where the services rendered by the employee were classified as illegal.

Impossibility of performance will also be discussed later in this text in chapter 15 dealing with termination of contract and remedies.

PRACTICALLY

SPEAKING

What is a '*force majeure*' clause?[34]

A *force majeure* clause in a contract excuses a party from not performing its contractual obligations due to unforeseen events beyond its control. These events include natural disasters such as floods, earthquakes, and other acts of God, as well as uncontrollable events such as war and terrorist attacks.

Force majeure clauses are meant to excuse a party, provided the failure to perform could not be avoided by the exercise of due diligence and care. However, it does not cover failures resulting from a party's financial condition or negligence.

Force majeure literally means 'greater force'. When used in a contract, a *force majeure* clause is one of several boilerplate clauses, which are clauses normally written using standard, universal language. Other common boilerplate clauses include arbitration clauses and entire agreement clauses.

The intention of a *force majeure* clause is to excuse liability of a party because of uncontrollable outside events. For example, you verbally agree to buy a house, and before you sign the contract, the house burned down due to a fire caused by lightning.

When negotiating *force majeure* clauses, make sure the clause applies equally to all parties. Be sure to include specific examples of events that will excuse performance under the clause.

The following are three basic categories of these kinds of events:

- Natural disasters, such as earthquakes, hurricanes, floods, tornados, and fires.
- Human events, such as wars, riots, or other major upheavals.
- Performance failures outside the control of the contracting party, such as disruptions in telephone service attributable to the telephone company; labour disputes other than those of the contractual parties; government restrictions (denial or cancellation of a necessary licence); or supplier problems (product unavailable).

Generally, the events that a *force majeure* clause does not cover include:

- Computer failures.
- Software glitches.
- Distributor troubles.
- Internal labour disputes.
- Credit problems.

The language of a *force majeure* clause should pertain to the area of business that the contract covers. Internet companies should put in provisions for electronic failures and service provider disruptions. The more specific you are as to the events covered under the clause, the better the contract will protect you.

Here is an example of a *force majeure* contract clause:

'Neither party shall be liable in damages or have the right to terminate this Agreement for any delay or default in performing hereunder if such delay or default is caused by conditions beyond its control including but not limited to acts of God, government restrictions (including the denial or cancellation of any export of other necessary licence), wars, insurrections and/or any other cause beyond the reasonable control of the party whose performance is affected (including mechanical, electronic, or communications failure).'

Courts could possibly exclude certain unforeseen events unless specifically listed in a *force majeure* clause. One way is to list in the contract as many of the possible

uncontrollable events that might cause the terms of the contract not to be fulfilled. As an extra precaution, add the phrase ‘including but not limited to’.

THIS CHAPTER IN ESSENCE

1. A contract will be void where it was impossible to perform it at the time it was entered into. A contract may be voidable where performance becomes impossible only after the contract was entered into.
2. South African law recognises two categories of impossibility: legal impossibility and physical impossibility.
3. An agreement in restraint of trade is one in which a person agrees to a future limitation on his or her trade or work. Courts distinguish between subjective knowledge and objective knowledge. Courts will generally find restraints of trade that restrict objective knowledge to be valid and enforceable unless they are unreasonable.
4. Performance under a contract must be legal. Where performance is illegal or immoral, the court will use two rules to assist in deciding whether to allow a remedy for performance made under an illegal contract: 'From an illegal cause no action arises', and 'In equal guilt the position of the possessor is stronger'.

QUESTIONS

Short question (1–5 marks)

1. List the essential requirements to establish subsequent impossibility of performance.

Paragraph questions (5 marks)

1. Write notes on restraints of trade.
2. What is meant by the phrase: 'From an illegal cause no action arises'.
3. Discuss the phrase, 'In equal guilt the position of the possessor is stronger' and its application to South African law.
4. Discuss physical impossibility of contract.

Essay question (10 marks)

1. Discuss legal impossibility of contract.

Problem question (20 marks)

1. Kevin, an ice cream manufacturer, employs Jenny in Johannesburg on a five-year contract as a specialist flavour developer and taster. A clause in Jenny's contract of employment provides that after the termination of the contract, she may never again participate in any way in the ice cream trade anywhere in Gauteng. One year after the termination of the contract, Louis, an ice cream manufacturer doing business in Pretoria, offers Jenny employment. Jenny accepts the offer. Advise Kevin of his legal position.

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1 *Scrutton v Erlich and Company* 1908 TS 300; Fouché, 95–98; Gibson, 56–58; Havenga et al., 80–82; Sharrock, 107.

2 *Peters Flamman and Company v Kokstad Municipality* 1919 AD 427.

3 *Yodaiken v Angerhn and Piel* 1914 TPD 254.

4 *South African Forestry Co Ltd v York Timbers Ltd* 2005 (3) SA 323 (SCA).

5 *Hersman v Shapiro and Company* 1926 TPD 367.

6 Kahn, *Contract and Mercantile Law through the Cases*, 149.

7 *Peters, Flamman and Company v Kokstad Municipality* 1919 AD 427.

8 *Orda AG v Nuclear Fuels Corporation of South Africa (Pty) Limited* 1994 (4) SA 26 (W).

9 *World Leisure Holidays (Pty) Ltd v Georges* 2002 (5) SA 531 (W).

10 Sharrock, 526–531.

11 *Lion Match Company Ltd v Wessels* 1946 OPD 376.

12 *Gibson v Van der Walt* 1952 (1) SA 262 (A).

13 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Company* [1894] AC 535 (HL).

14 *Magna Alloys and Research (SA) (Pty) Ltd v Ellis* 1984 (4) SA 874 (A).

15 *Roffey v Catterall Edwards and Goudre (Pty) Ltd* 1977 (4) SA 494 (N).

16 *Die Dros (Pty) Ltd and another v Telefon Beverages CC and others* [2003] 1 All SA 173 (C).

17 *Cowan v Pomeroy* 1952 (3) SA 646 (C); *Diner v Carpet Manufacturing Company of South Africa Ltd* 1969 (2) SA 101 (D).

18 *Highlands Park Football Club Ltd v Viljoen and another* 1978 (3) SA 191 (W).

19 *Thompson v Nortier* 1931 OPD 147.

20 *BHT Water Treatment (Pty) Ltd v Leslie and another* 1993 (1) SA 47 (W).

21 *Sunshine Records (Pty) Ltd v Fröhling and others* 1990 (4) SA 782 (A).

22 *National Chemsearch (Pty) Ltd v Borrowman* 1979 (3) SA 1092 (T).

23 *Brisley v Drotsky* 2002 (4) SA 1 (SCA).

24 *Waltons Stationery Co (Edms) Bpk v Fourie en 'n ander* 1994 (4) SA 507 (O) at 510D–511E.

25 Constitution of the Republic of South Africa, 1996.

26 *Waltons Stationery Co (Edms) Bpk v Fourie en 'n ander* 1994 (4) SA 507 (O); *Kotze en Genis (Edms) Bpk v Potgieter en andere* 1995 (3) BCLR 349 (C); *Knox D'Arcy Limited and another v Shaw and another* 1995 (12) BCLR 1702 (W); *Coetzee v Comitis and others* 2001 (1) SA 1254 (C); *Fidelity Guards Holdings (Pty) Ltd t/a Fidelity Guards v Pearmain* 2001 (2) SA 853 (SEC) at 862F–H; *Canon KwaZulu-Natal (Pty) Ltd t/a Canon Office Automation v Booth and another* 2005 (3) SA 205 (N); *Barkhuizen v Napier* 2007 (5) SA 323 (CC); 2007 (7) BCLR 691 (CC); *North Safety Products (Africa) v Nicolay and others* [2007] 3 All SA 647 (C); *Advtech Resourcing (Pty) Ltd t/a The Communicate Personnel Group v Kuhn and another* 2008 (2) SA 375 (C); [2007] 4 All SA 1368 (C); *Digicore Fleet Management v Steyn* [2009] 1 All SA 442 (SCA).

27 *Digicore Fleet Management v Steyn* [2009] 1 All SA 442 (SCA).

28 *Lion Match Company Ltd v Wessels* 1946 OPD 376.

29 *Brandt v Bergstedt* 1917 CPD 344; *Friedman v Harris* 1928 CPD 43; *Limbada v Dwarka* 1957 (3) SA 60 (N).

30 *Jajbhay v Cassim* 1939 AD 537; *Peterson v Jajbhay* 1940 TPD 182; *Padayachey v Lebese* 1942 TPD 10.

31 *Jajbhay v Cassim* 1939 AD 537.

32 *Peterson v Jajbhay* 1940 TPD 182.

33 *Kylie v CCMA and others* 2010 (4) SA 383 (LAC).

34 Source: www.allbusiness.com/legal/contracts-agreement/54-1.tml, accessed 8 September 2008. Copyright © 1999–2012 AllBusiness.com. Inc. All rights reserved.

Chapter 14

Common contractual provisions and third parties to a contract

'Whenever men take the law into their own hands, the loser is the law. And when the law loses, freedom languishes.'

ROBERT KENNEDY (1925–1968)
AMERICAN POLITICIAN

What is covered in this chapter

1 Terms and conditions of contract

2 Special clauses in a contract

3 Amendment of contract

4 Third parties to a contract

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

People often use the expression ‘terms and conditions of contract’. It is important that you understand that there are differences between ‘terms’ and ‘conditions’, and the meaning of each.

Also, it is useful for you to be able to identify special clauses that are typically contained in contracts. Even though they may not be essential to the nature of the contract, such clauses can be very useful because they set out practical ways to perform the contract. When you understand what each clause is trying to accomplish, you will know why that clause is contained in the contract.

Every contract contains rights and duties. It is possible for the parties to transfer either the rights, or the duties, or both the rights and the duties, to another person. This happens often, such as when a shop sells a bad debt to another company, or when a contract is entered into for a company that has not yet been registered. This chapter will show you how this is done.

1 Terms and conditions of contracts

A ‘condition’ in a contract is a provision of the agreement that affects its existence. It determines whether or not there is a contract. If the condition is fulfilled, it has an automatic effect. It means that the contract either exists, or does not exist.

In legal terms, a conditional contract is an agreement where performance is dependent on the occurrence or non-occurrence of a future uncertain event. The event must be physically and legally possible. The fulfilment of the condition must not depend entirely on the will of one of the parties.[1]

A ‘term’ of contract describes the rights and duties that the parties to a contract have agreed to.

1.1 Terms

Terms in a contract may be either express or implied:[2]

- **Express terms**: These terms are specifically stated, either in writing or verbally. As the terms are based on the intentions of the parties, there are usually no problems regarding whether or not express terms form part of the contract.
- **Implied terms**: These are terms that are not stated in words, but may be implied by law or from the surrounding circumstances at the time the contract was entered into.

The parties may regard some terms as being so obvious that they are not expressly stated. If the court believes that the parties intended to add these terms into their agreement they will then be implied or ‘read into the contract’. However, this will only happen if it is necessary in a business sense to give effect to the contract.[3] A term will not be inferred simply because it would be convenient and could therefore have been incorporated into the contract if the parties thought about it at the time.[4]

In deciding whether an implied term has to be read into a contract, a court has to work out the intentions of the parties by considering the language used by the parties in their contract.[5] The court will not imply into the contract a term that conflicts with the express agreement.[6] Similarly, the court will not imply a term into a contract that is not clear, or where either of the parties would want to negotiate further on the outcome of the implied term.[7]

Consol Ltd t/a Consol Glass v Twee Jonge Gezellen (Pty) Ltd and another [8]

The court held that the test for establishing the existence of a tacit term in a contract is the 'officious bystander test'. In terms of this test the term will be imported if the bystander's question, 'What will happen in such a case?' would have been answered by both contracting parties saying, 'Yes, of course, this will happen; we just did not bother to say that; it is obvious'.

The inference of a tacit term can be justified only if the bystander's question would have resulted in a prompt and unanimous assertion of the suggested term from both contracting parties. If one of the parties seeks clarification or requests some time to consider before giving an answer, the term would not pass the bystander test.

Common-law rules and trade usages may also be read into the contract. For a trade usage to be valid, it must be generally well known, definite, reasonable, legal, and not specifically excluded by the terms of the contract.[9]

1.2 Conditions

A legal consequence or the performance of a contract may be made dependent on the occurrence or non-occurrence of a future uncertain event. The event must be physically and legally possible. The fulfilment of the condition must not depend entirely on the will of one of the parties.[10]

South African law recognises two types of conditions that may apply to contracts:[11]

- **Suspensive conditions**: Rights and duties are delayed until the specified event happens. Once the event occurs, the condition is fulfilled. The effect is retroactive to the time when the contract was entered into and the parties must now perform the contract. If the condition is not fulfilled, the law deems that there never was a binding contract.[12]

For example, the purchase of a house is made subject to the suspensive condition that a loan will be approved by a bank. If the loan is granted, the buyer must pay and the seller must take the money. If the loan is not granted, there never was a contract.

- **Resolutive conditions**: Performance of a contract must be carried out until the condition is fulfilled. If the condition is fulfilled, the performance comes to an end retroactively and the parties must be restored to their original positions to the greatest extent possible.[13]

  For example, the purchase of a house is made subject to the resolutive condition that the offer to purchase will lapse if the seller receives a higher offer. Both parties must perform immediately under the contract, but if a higher offer is received the contract is terminated.

Either suspensive or resolutive conditions may be described as:

- **Casual**: The possibility of the future event not happening is dependent on the decision of a third person, or on chance.
- **Potestative**: The possibility of the future event not happening is dependent on the decision of a party to the contract.
- **Mixed**: A combination of both casual and potestative features.

Where it is possible for a party to prevent a condition from being satisfied, and deliberately does so, the law provides that the condition will be deemed to be fulfilled. This is known as the ‘doctrine of fictional fulfilment of a condition’.[14]

2 Special clauses in a contract

Typical clauses may include the following:

- **Indemnity clause**: The parties may agree that one or both of them is exempted from certain kinds of liability that might apply.
- **Non-variation clause**: The parties can agree that the terms of the contract cannot be changed unless both of them comply with specific formalities. For example, that the changes must be in writing and signed by both of them before any change will be effective.
- **Cancellation clause**: The parties can agree that any failure to comply with the terms of the agreement will entitle an aggrieved party to cancel the contract immediately.
- ***Domicilium citandi et executandi***: The parties can agree on specific addresses for the delivery of legal notices and court documents to each other.
- **Notice**: The parties can agree that notices will be deemed to have been received if they are issued in specific ways. For example, they may agree that a letter sent by registered post will be deemed to have arrived five days after being sent.
- **Jurisdiction**: To help reduce costs if there is a legal dispute, the parties can agree that legal action can be instituted in a magistrates' court rather than a High Court.
- **Arbitration**: To help reduce complexity and make litigation quicker, the parties can agree that legal action must be taken through arbitration rather than going to court.
- **Costs**: The parties can agree that the loser of any legal action will pay the winner's entire ‘attorney-and-own-client’ legal costs, rather than just the limited ‘party-and-party’ costs that may be awarded by the court.

3 Amendment of contract

The parties may amend any contract they have entered into. In general, no formalities are required unless formalities for the original contract are prescribed by statute, or unless the parties had previously agreed to a non-variation clause in the contract.

4 Third parties to a contract

The general rule is that when persons contract they can bind only themselves unless they act in a ‘representative capacity’. This means that they act on behalf of someone else to be bound on the contract. It is however possible for someone to agree to give another person the rights, or the duties, or both the rights and the duties, that flow from the contract. These are situations in which cession, delegation or assignment of the contract takes place.[15]

In a contract, one party has a right to have the other party perform the duty promised. The person who must perform the duty is referred to as the ‘debtor’. The person who may expect the other to perform the duty is the ‘creditor’. In legal terms, a creditor is a contracting party who can enforce a right, whereas a debtor is a contracting party who must comply with an obligation.

It is possible for there to be two or more debtors called ‘co-debtors’. Where co-debtors share ‘joint liability’ for a debt, the creditor only may demand that each perform his or her proportionate or *pro rata* share of the total debt. Where co-debtors are ‘jointly and severally’ liable the creditor may choose to hold any one of the debtors fully liable for the total debt. Joint and several liability is also known being liable *in solidum*. The debtor who paid the creditor the full amount may then claim payment from the other debtors, in proportion to the amount for which each one was liable.

Unless the parties agree otherwise, the general rule is that co-debtors share joint liability, and are not jointly and severally liable. This is different to the situation in a partnership, where the partners are jointly and severally liable for partnership debts.

There also may be more than one creditor in a contract, in which case they are called ‘co-creditors’.

4.1 Contract for the benefit of a third party

A contract for the benefit of a third person is also known as a *stipulatio alteri*. An example of a contract for the benefit of a third person is when A contracts with B that A will keep an offer open for C to accept. In legal

terms, this means that a promissory and a promissee agree that the promissory will keep an offer open for acceptance by a third party. Although C was not a party to the original contract, C may accept the offer by notifying A, after which B drops out of the picture. The contract now exists only between the promissory and the third party.

The contract is only binding on the third party after he or she accepts the offer. Once this happens the third party accepts both the rights and the duties of the contract. C may then enforce the contract. C is not obliged to accept the offer. If C rejects the offer, the contract falls away.[16]

It is not necessary for C to be in existence at the time when A and B make the contract, but A and B must have intended the contract to be for C's benefit.[17]

Until acceptance takes place, the agreement continues to be one solely between A and B and can be changed by agreement between them.[18]

The promissory may not withdraw from the contract with the promisee unilaterally. Once the third party has accepted the offer, it is irrevocable even by agreement between the promissory and the promissee.[19]

There are many practical situations where people enter into contracts for the benefit of a third party. For example, where people contract for the benefit of a company that has not yet been formed.

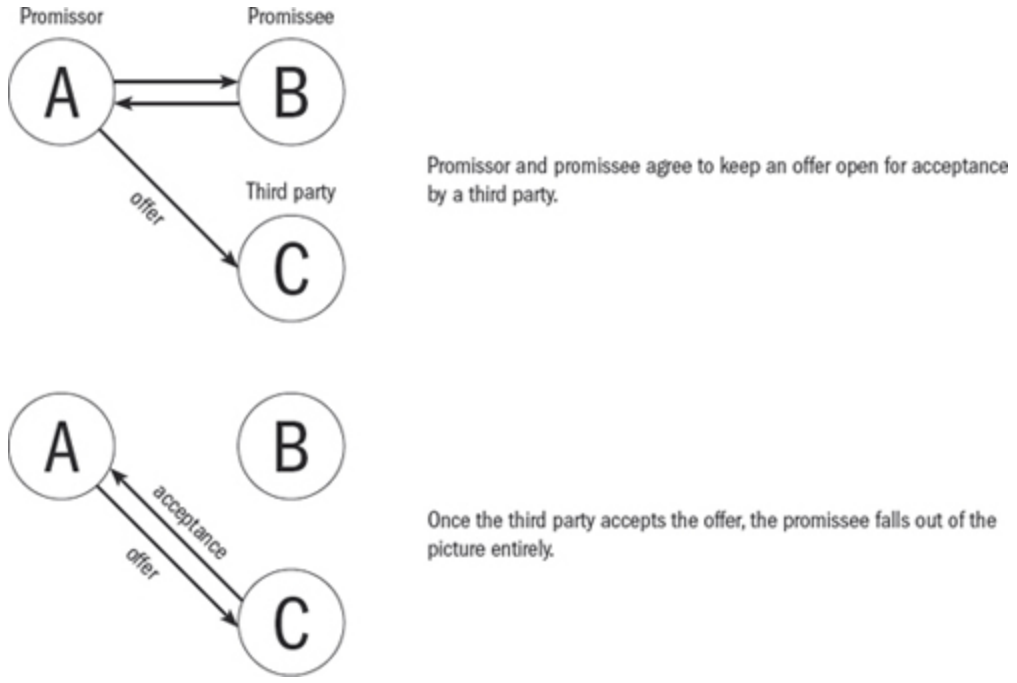

Figure 14.1 *Contract for the benefit of a third person*

4.2 Assignment

Each party to a contract is at the same time a debtor and a creditor. 'Assignment' has the effect of substituting a third party for one of the parties to a contract in the capacity of both debtor and creditor. The consent of all three parties is required before assignment can take place. In effect, there is an agreement to end the existing contract and substitute a new one for it. This type of replacement is called 'novation'.[20]

4.3 Cession

'Cession' is the process by which one party called a 'cedent' transfers personal rights to another party called a 'cessionary'. In general, no formalities are required. All that is necessary is a contract between cedent and cessionary. As between cedent and cessionary, a right may be validly ceded by simple oral agreement.[21]

Cession, just like delivery, involves a shift of assets from one estate to another. Upon a valid cession, the cedent generally loses his or her rights against the debtor, with those rights now vesting in the cessionary. As a

general rule, cession of a right can occur without the consent of, or even notice to, the debtor.[22]

The legality of a cession does not depend on the legality of the underlying reason for the cession. The legality of the cession and the legality of the underlying reason are two different issues. Where performance has not yet happened the cedent will be able to sue the cessionary for the return of the right; where performance has already occurred, the cedent may sue the cessionary on the basis of unjustified enrichment.

Formalities are generally not required. All that is necessary is an agreement between cedent and cessionary. No document needs to be delivered; a right may be validly ceded by oral agreement.

Botha and another v Carapax Shadeports (Pty) Ltd [23]

Two salespeople were employed by a close corporation. In their contracts of employment they had signed restraints of trade prohibiting them from competing with the CC within a specified geographic area for one year after their employment ended. The business of the CC as a going concern and its goodwill was then taken over by a new company. After this the two sales representatives left and opened up their own business in competition. The court had to decide whether the new company could enforce the restraint of trade against the two former employees. The two argued that there had been no cession of the CC's rights in respect of the restraint, and that this meant that the new company could not prevent them from competing.

The court held that the benefit of an agreement in restraint of trade exists for the advantage of a business. This benefit passes to the purchaser of a business as part of the goodwill. A restraint of trade agreement therefore forms part of the goodwill and accordingly part of the assets of the business irrespective of whether the business is conducted by a company or by an individual. This meant that the restraint could be enforced by the new company.

It is advisable to give the debtor notice of the cession. If notice of the cession has been given, payment by the debtor to the cedent will not discharge the debt. But if notice has not been given, payment in good faith by the debtor to the cedent will do so.[24]

A future right also may be validly ceded. The validity is subject to the suspensive condition that the cedent obtains the right to be ceded.

The requirements for a valid cession are:[25]

- The cedent must hold the rights being transferred.

- The right must be capable of being transferred.
- The cedent must have the intention to transfer the right, and the cessionary the intention to acquire it.
- The object of the cession must be properly described.
- The cession must be lawful.

If the debtor is sued by the cessionary, he or she may raise any defence that could have been raised against the cedent. This is because the cessionary steps into the shoes of the cedent and can have no greater rights than the cedent had. These defences include fraud, duress, prescription, payment, and set-off.

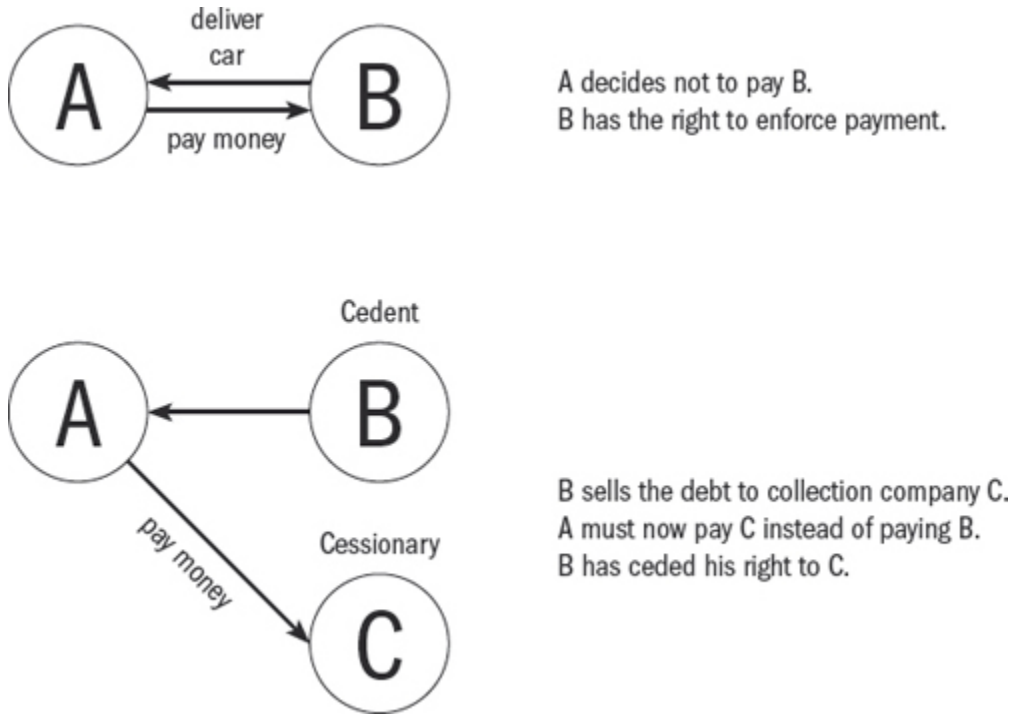

Figure 14.2 *A simple view of how cession works*

In a typical example, such as A buys a car from B for R1 000, we can see that A must pay money, and B must deliver the car. After the car is delivered, A tells B that he has no money and cannot afford the repayments. B sells the debt to a debt collection company, C. C now demands payment from A. In simple terms, B has sold his right for payment from A, to C. In legal terms, B has ceded the debt to C.

The right of a person to cede rights may be limited by common law, agreement, or statute:

- **Common-law restrictions**: Wherever the right to be ceded is of so personal a nature that the debtor has a substantial interest in making performance to one person only (for example in contracts of employment), cession cannot take place without the debtor's consent.[26]

  An action for compensation for harm to an interest of personality, such as defamation or loss of dignity, cannot be ceded before litigation has started.[27]

  A cession of part of a debt is invalid without the consent of the debtor.[28]

  The cession must not have been made deliberately to deprive the debtor of his or her right to raise set-off of an amount owed.[29]

- **Restrictions by agreement**:[30] In this situation a restriction is agreed by the parties to be a term of the contract. Restrictions imposed by agreement become important when the cessionary, to whom rights have been ceded by a cedent, in turn cedes these rights to yet another person. This is known as ‘on-ceding’. A cedent who has consented to an on-cession may impose a limitation on the security given to the on-cessionary.[31]

  Can this cessionary on-cede greater rights than the rights obtained initially to secure the indebtedness to this other person? According to the principle that no one can pass on greater rights than he or she receives, a cedent cannot give the cessionary more rights that the cedent has against the debtor. This is also known as the *nemo plus iuris* principle.

Sechold Financial Services v Gazankulu Development Corporation [32]

A client borrowed R5 million from GDC and ceded insurance policies to secure the loan. GDC entered into a loan agreement with SFS to provide the finance, and on-ceded the policies to SFS for R19 million. When GDC defaulted on the loan agreement, SFS sued for R19 million from the proceeds of the on-ceded policies. GDC argued that SFS was only entitled to R5 million, being the amount that GDC had paid over to the client.

The court held that the security of the on-cessionary was limited to the rights the cessionary had against the cedent.

- **Statutory restrictions**:[33] Laws prohibit cession of compensation under the Compensation for Occupational Injuries and Diseases Act;[34] pensions generally, and earnings of insolvents in terms of the Insolvency Act.[35]

4.4 Delegation

Delegation has the effect of substituting a third party in the capacity of debtor.[36] The consent of all three parties is necessary before a debtor can delegate his or her responsibility for payment of a debt to a third party. In effect there is a novation, as in the case of assignment, to which the creditor, the original debtor, and the proposed debtor all have to give their consent.[37]

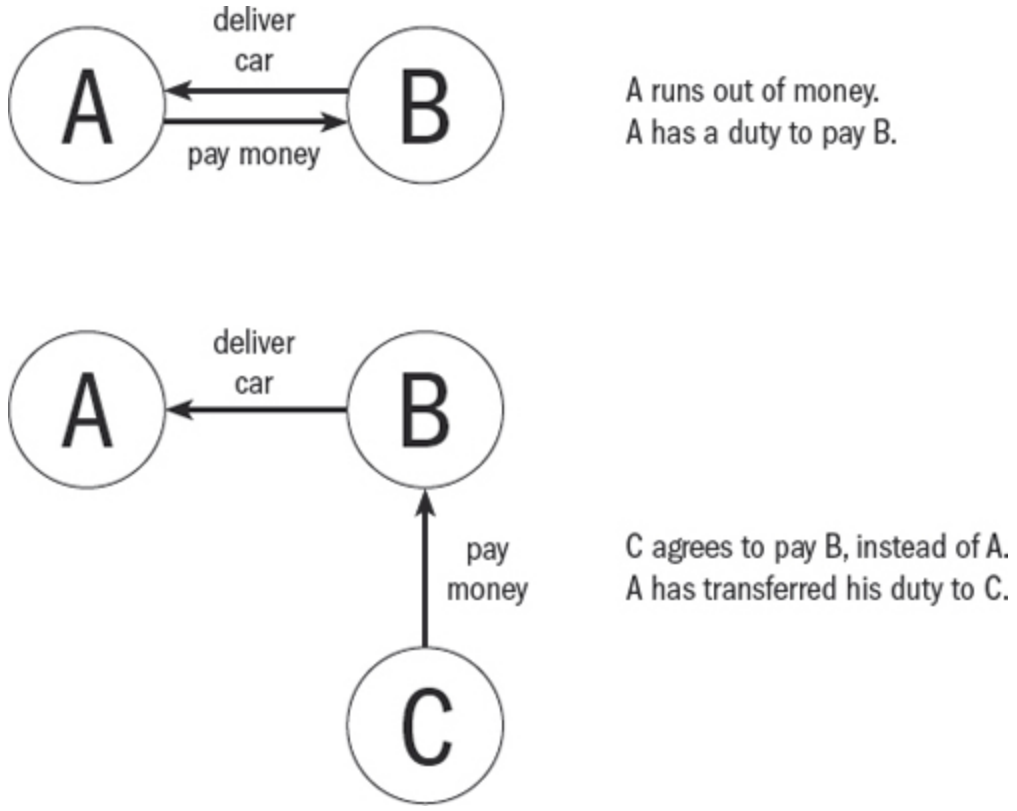

Figure 14.3 *A simple view of how delegation works*

In a typical example, such as A buys a car from B for R1 000, we can see that A must pay money, and B must deliver the car. After the car is delivered, A tells B that he has no money and cannot afford the repayments. C, who is A's father, agrees to make the payments instead. In simple terms,

A has given his duty to pay B, to C instead. In legal terms, A has delegated the debt to C.

PRACTICALLY

SPEAKING

Some things to look for in a commercial contract

Your business will enter into many verbal and written contracts with suppliers and customers. Even though there will be an offer and an acceptance of some sort in every contract, it is much easier to prove each party's rights and obligations when a contract is in writing. But even written contracts can be vague or lack some of the detail over which people may later argue. It is always a good idea to spend some time thinking about the terms and conditions that you would want in a written contract if a disagreement later becomes a dispute. What would you write into your contract at the time it was signed that would help you avoid a dispute, and to win any court case in future?

In some cases your business may be a customer to a supplier, and in other cases your business will supply customers. It is useful to understand that clear and detailed terms and conditions of contract help you in both situations. Here are some tips to consider:

- **Incorporation by reference**: You may think that you just want a customer to sign your quotation, without needing to give them a copy of all the terms and conditions of contract because these are printed on a delivery note or receipt. Remember that you cannot add terms and conditions after the contract is concluded, unless the other side knowingly agrees. Sending a customer the terms and conditions after he has signed the agreement is of no use to you.
- **Consumer protection**: Courts will not look kindly at suppliers that try to take advantage of consumers. Even if the consumer agrees to terms and conditions that are one-sided in your favour, a court will not enforce an agreement that results in unfairness to the customer.

Be very careful with the following:

- **Consumer credit**: Make sure the National Credit Act is complied with. Even when you advertise credit there are laws to comply with. It would be wise to have your attorney read all the forms and marketing material you intend to use.
- **Unfair or unconscionable contract terms**: Make sure the Consumer Protection Act is complied with. It would be wise to have your attorney read all the forms and marketing materials you intend to use.
- **Cooling-off periods**: By law, some customers will be entitled to a cooling-off period, and some will not. Make sure you understand how the Consumer Protection Act may apply to certain transactions, and when it will not.

THIS CHAPTER IN ESSENCE

1. Terms in a contract may be either express (specifically stated in words) or implied (unstated).
2. A condition can make a legal consequence or the performance of a contract dependent on the occurrence or non-occurrence of a future uncertain event. Conditions can be suspensive or resolutive.
3. A contract for the benefit of a third person is also known as a *stipulatio alteri*.
4. Assignment has the effect of substituting a third party for one of the parties to a contract in the capacity of both debtor and creditor.
5. With a valid cession, the rights of a cedent (to enforce a contract with a debtor) are transferred to a third party called a cessionary.
6. With a valid delegation, the obligations of a debtor (to perform a contract with a creditor) are transferred to a third party.

QUESTIONS

Short questions (1–5 marks)

1. What is a suspensive condition?
2. What is a resolutive condition?
3. Distinguish between express and implied terms of contract.
4. What is ‘on-cession’?
5. What is a *stipulation alteri*?

Paragraph questions (5 marks)

1. Discuss assignment.
2. Discuss delegation.

Essay questions (10 marks)

1. Distinguish between a suspensive condition and a resolutive condition by using examples of each.
2. Discuss cession.

Problem question (20 marks)

1. Graham sells his car to Harry for R5 000 and Harry agrees to pay cash. The next week, however, Harry finds that he can only pay R3 000 in cash to Graham and asks Graham to allow him to pay the balance of R2 000 in two months' time. Graham agrees. One month later, Graham informs Harry that he must not pay the R2 000 to himself, but rather to Isaac, to whom Graham owes R2 000 for painting Graham's house. Explain in legal language what the parties have done.

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1 *R v Katz* 1959 (3) SA 408 (C) at 417; Fouché, 95–97; Gibson, 82–84; Havenga et al., 86–88; Sharrock, 200–203; Swanepoel et al., 61–62.

2 Fouché, 108; Gibson, 45–47; Havenga et al., 85–86; Sharrock, 161–165; Swanepoel et al., 59–61.

3 *Alfred McAlpine and Son (Pty) Ltd v Transvaal Provincial Administration* 1974 (3) SA 506 (A).

4 *City of Cape Town (CMC Administration) v Bourbon-Leftley NO and another* [2006] 1 All SA 561 (SCA).

5 *Birkenruth Estates (Pty) Ltd v Unitrans Motors (Pty) Ltd (formerly Malbak Consumer Products (Pty) Ltd) and others* 2005 (3) SA 54 (W).

6 *Transnet Ltd v Rubenstein* [2005] 3 All SA 425 (SCA); *City of Cape Town (CMC Administration) v Bourbon-Leftley NO and another* [2006] 1 All SA 561 (SCA).

7 *Technipak Sales (Pty) Ltd v Hall* 1968 (3) SA 231 (W); *Bundshuh v Finnegan* 1975 (1) SA 376 (C).

8 *Consol Ltd t/a Consol Glass v Twee Jonge Gezellen (Pty) Ltd and another* 2005 (6) SA 1 (SCA).

9 *Coutts v Jacobs* 1927 EDL 120.

10 *R v Katz* 1959 (3) SA 408 (C) at 417.

11 Kahn, *Contract and Mercantile Law through the Cases*, 208.

12 Sharrock, 201–202.

13 Sharrock, 203.

14 *MacDuff and Company Ltd (in liquidation) v Johannesburg Consolidated Investments Co Ltd* 1924 AD 573; *Scott v Poupard* 1971 (2) SA 373 (A).

15 Fouché, 110; Gibson, 87–92; Kahn, *Contract and Mercantile Law through the Cases*, 221; Swanepoel et al., 56.

16 *McCullough v Fernwood Estate Ltd* 1920 AD 204; Sharrock, 229–231.

17 *Baikie v Pretoria Municipality* 1921 TPD 376.

18 *Buttar v Ault NO* 1950 (4) SA 229 (T) at 238; Fouché, 104; Gibson, 87–88.

19 Sharrock, 229–231.

20 *Rathibe v Reid* 1927 AD 74; Fouché, 105; Gibson, 88; Sharrock, 221.

21 *Botha v Fick* 1995 (2) SA 720 (A); Fouché, 105; Gibson, 88–92; Havenga et al., 111–114; Sharrock, 214–220; Swanepoel et al., 56–57.

22 *Estate Van den Heever v Greyling* (1907) 24 SC 414; *Lovell v Paxinos and Plotkin: In re Union Shopfitters v Hansen* 1937 WLD 84; *Van Aswegen v Pienaar* 1967 (3) SA 677 (O) at 680H.

23 *Botha and another v Carapax Shadeports (Pty) Ltd* (560/1989) [1991] ZASCA 134; 1992 (1) SA 202 (A); [1992] 3 All SA 768 (A) (27 September 1991).

24 *Estate Van den Heever v Greyling* (1907) 24 SC 414; *Opperman v De Beer* 1915 TPD 91; *Lovell v Paxinos and Plotkin: In re Union Shopfitters v Hansen* 1937 WLD 84; *Katz v Katzenellenbogen* 1955 (3) SA 188 (T) at 190 G; *Brook v Jones* 1964 (1) SA 765 (N) at 767C; *Illings (Acceptance) v Ensor* 1982 (1) SA 570 (A) at 578F.

25 *Johnson v Incorporated General Insurance Ltd* 1983 (1) SA 318 (A); Sharrock, 216–218.

26 *Eastern Rand Exploration Company v Nel* 1903 TS 53; *Cullinan v Pistorius* 1903 ORC 38; *Sasfin v Beukes* 1989 (1) SA 1 (A) at 31.

27 *Government of the Republic of SA v Ngubane* 1972 (2) SA 601 (A) at 607; *Schoultz v Potgieter* 1972 (3) SA 371 (EC) at 372H.

28 *Spies v Hansford and Hansford Ltd* 1940 TPD 1; *Lief NO v Dettmann* 1964 (2) SA 252 (A) at 275.

29 *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 (1) SA 747 (A).

30 *Paiges v Van Ryn Gold Mines Estates Ltd* 1920 AD 600; *Trust Bank of Africa Ltd v Standard Bank of SA Ltd* 1968 (3) SA 166 (A); *MTK Saagmeule (Pty) Ltd v Killyman Estates (Pty) Ltd* 1980 (3) SA 1 (A).

31 *Oertel v Brink* 1972 (3) SA 669 (W).

32 *Sechold Financial Services v Gazankulu Development Corporation* 1997 (3) SA 391 (A).

33 Sharrock, 214–216.

34 Compensation for Occupational Injuries and Diseases Act 130 of 1993.

35 Insolvency Act 24 of 1936.

36 Fouché, 106; Gibson, 92; Havenga et al., 115.

37 *Van Achterberg v Walters* 1950 (3) SA 745 (T).

Chapter 15

Termination of contract and remedies

'It is an immutable law in business that words are words, explanations are explanations, promises are promises – but only performance is reality.~'

HAROLD GENEEN (1910–1997)
AMERICAN BUSINESSPERSON

What is covered in this chapter

1 Termination of a contract

2 Remedies

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

Just because someone does not keep to the terms of the contract does not necessarily mean they may be entitled to cancel it without first taking further steps. The defaulting party must first be made to be in ‘breach’ of the contract before an aggrieved person can choose to cancel it. Mere failure to perform is generally not enough for someone to be ‘in breach’.

Breach may be made to happen in one of several different ways – it is important that you understand the different ways that a party may be in breach, and the steps that should be taken before an aggrieved person is able legally to cancel a contract.

Very often people ignore these steps, and get upset in court when they then lose a case. It is therefore vital that we understand how contracts can be legally terminated, and the legal rights and duties on both sides if someone does not comply with the terms of the contract.

We also need to understand when contracts end normally, and the circumstances under which you can walk away from a contract or terminate it.

Lastly we need to examine the remedies available to someone who is unhappy with the other person's performance under the contract.

1 Termination of a contract

There are twelve situations in which contracts may end or be terminated.

1.1 Performance or payment

This is the most common way of ending contracts: each party simply does what he or she was meant to do. If the debt is a money debt, the creditor is entitled to payment in legal tender, that is, bank notes and coins. Bank notes must be accepted for any amount; silver coins up to R4,00; and bronze or copper coins up to 10 cents. Payment by cheque (other than post-dated cheques) is equivalent to payment by cash, subject to the condition that the cheque will be paid.[1]

Where several debts are owed to the creditor, the creditor may inform the debtor that he or she will allocate a payment in respect of a certain debt, generally one that bears interest, or the oldest debt. This is known as ‘appropriation of payments’.

Interest is normally paid first; any amount left over is used to reduce the capital amount still due. Where money is paid to a creditor in the mistaken belief that the debtor is indebted to the creditor, there is no contract to sue upon. Instead, the debtor may sue for unjustified enrichment to recover his or her money using an action known as the *condictio indebiti*.

1.2 Release

This is known as ‘waiver’, or ‘discharge by agreement’. The parties may waive their rights and release each other from their respective rights and obligations.[2]

1.3 Novation

It is possible to substitute a new contract for the original one. This is known as ‘novation’. Novation has the effect of discharging the original obligation and substituting a new one in its place.[3]

Common forms of novation include:

- **Compromise**: The parties, by agreement, may settle an obligation. For example, the debtor tenders to the creditor a lesser amount than that which he or she owes, in full and final settlement.
- **Cession**: This has the effect of creating a new creditor, and has been discussed previously.
- **Delegation**: This has the effect of creating a new debtor, and has been discussed previously.

1.4 Merger

'Merger' occurs when the qualities of debtor and creditor coincide in the same person in respect of the same obligation. For example, when a tenant purchases the same property that he or she has been renting.[4] Merger may also be known as *confusio*.

Grootchwaing Salt Works Ltd v Van Tonder [5]

A tenant hired land with a salt-pan. The lease gave the tenant rights to some of the adjoining ground, which was not let. The tenant later bought the ground over which the lease had existed.

The court held that the rights over the adjoining ground had come to an end.

1.5 Impossibility of performance

A contract that is initially impossible to perform is void.

Supervening impossibility of performance is voidable. The contract is discharged as though it had been impossible from the very beginning. All rights and duties between the parties fall away, and there is no breach or liability for damages. What has already been performed is usually recoverable on the basis of unjustified enrichment.

Supervening impossibility may arise through an act of God, such as a natural disaster, or through an unavoidable situation, such as where the law is changed to make performance illegal, or where a person whose good health is essential to performance dies or becomes incapacitated.[6]

Peters Flamman and Company v Kokstad Municipality [7]

A contract had been entered into a few years before the First World War to provide lighting services for a period of 20 years. The partners of the suppliers were found to be enemy aliens, and interned. The business was wound up in terms of legislation that prohibited trading with enemies of the country.

The court held that it had become impossible for the partners to render the performance required in terms of the contract.

Supervening impossibility will not discharge a contract in any of the following cases:

- The parties expressly or impliedly agreed that it should not.[8]
- The impossibility is relative or subjective, rather than objectively absolute.

Hersman v Shapiro and Company [9]

A dealer in corn sold a consignment in advance. He argued that because of a crop failure it was impossible to deliver the goods.

The court held that there had been no evidence that the right quality and quantity of corn was absolutely unobtainable in all growing areas. The nature of the speculative contract meant that it would have been contemplated by the seller that he might have to pay more than the resale price if there was a scarcity of corn available.

- The impossibility is due to the fault of the person relying on it.[10]

Benjamin v Myers[11]

The tenant of a garage broke the law relating to the supply of petrol. In terms of his lease, he had undertaken to provide petrol for sale at the garage.

The court held that the tenant could not defend the action of the landlord in evicting him, as the impossibility was due to his own wrongful conduct.

- The debtor has failed to perform on time, unless he or she can show that the event would have occurred in any case. The default of the debtor may also be referred to as being *in mora*.

1.6 Set-off

If each party to a contract is indebted to the other party, the debts are balanced against each other. The smaller debt is discharged and the difference is all that is owed, or, if both debts are equal, they are both discharged and nothing is owed.[12]

For set-off to operate, four requirements must be met:

- The debts must be due between the same parties in the same capacities.
- Both debts must be of money or movable property of the same kind.
- The debts must be liquid, that is, fixed or in amounts that are easy to determine. If a debt is liquid this means that its exact amount is known and no evidence is required to establish the amount owed.
- Both debts must be unconditional, due, and payable.

The parties may agree to exclude any set-off from operating.[13] Set-off may also be known as *compensatio*.

1.7 Prescription

In terms of the Prescription Act,[14] it is possible to acquire rights, or be released from obligations, simply by the passing of time. In this way, prescription provides legal certainty.[15]

Types of prescription:

- **Acquisitive prescription**: The right of possession becomes the right of ownership if the thing is possessed with the intention of it being kept as if it were owned, for an uninterrupted period of 30 years. For example, I find a gold coin on my property. After 30 years it will be mine.
- **Extinctive prescription**: This is the lapsing of the claim by the passing of time. In this way the law provides that creditors only have a limited amount of time in which to claim debts owed to them, or they lose their rights. Extinctive prescription will apply for different time periods in respect of different rights:
    - **Thirty years**: Debt secured by a mortgage bond, judgment debt, or taxes, mineral royalties, or profits payable to the State.
    - **Fifteen years**: Debt owed to the State as result of a loan, or sale or lease of land to the debtor by the State.
    - **Six years**: Debt arising from a bill of exchange, negotiable instrument, or notarial contract.
    - **Three years**: Any other debt or claim.

Controversial cases involving prescription deal with situations where legal action starts a long time after the original events happened. Courts are

sometimes faced with difficult decisions as to when a debt became due, or when the cause of action arose – if a plaintiff delays starting legal proceedings for too long, the defendant may argue successfully that the claim has prescribed.

Van Zijl v Hoogenhout [16]

A woman claimed she had been sexually abused by her uncle from the age she was six until she reached fifteen years of age. This lasted from 1958 to 1967.

The abuse caused long-term physical, psychological and emotional damage. Although she reached majority in 1973, she instituted the action against the alleged abuser only in 1999. When she sued in 1999, the respondent alleged that the claim had prescribed in 1976, three years after she had turned 21.

The court held that prescription penalised unreasonable inaction, not inability to act. The evidence showed that she had not been aware until 1997, when she watched a television programme dealing with child sexual abuse and later talked to a friend who studied psychology, that it was not she, but her abuser, who was responsible for the assaults. It was only then that she acquired a rational appreciation that he was to blame and thus a meaningful knowledge of the wrong that set prescription in motion.

M Deysel v Dr R Truter and another [17]

A man who had five operations in 1993 on his one eye, had two more operations including that of the eye being removed in 1997. From that time he approached numerous medical authorities, and instructed four different attorneys who approached two different experts, unsuccessfully, to determine what had gone wrong. Only in February 2000 did his fifth attorney find an expert to give an expert opinion that the defendants were negligent, and summons was issued.

The defendants argued that the claim had prescribed in 1993.

The court considered that the plaintiff had sought tirelessly for an expert opinion to enable him to institute action. He had been advised by his attorneys at various stages that to institute an action without such an expert opinion could be defamatory. It was not legally conceivable how a malpractice case would ever be heard in court without a litigant obtaining medical expert knowledge that the symptoms complained about or the resultant consequence was indicative of some degree of incompetence or negligence constituting the wrongful act.

Accordingly, the court held that the plaintiff had acquired knowledge ascertaining the wrongful act only in the year 2000, and that his claim had not prescribed.

1.7.1 Interruption of prescription

On the occurrence of certain events, the time period for the prescription of rights may be extended for a period of time.

If the debtor expressly or tacitly acknowledges liability for the debt, prescription starts to run again from the date of that acknowledgement. For

example, by paying an instalment on a debt, the debtor acknowledges liability for the debt. Prescription will start again from the date of payment.

If the parties agree to extend the due date for payment of a debt, then prescription starts to run from the new date.

Prescription is interrupted for a period of one year if summons is served on the defendant. Once served, the plaintiff has 12 months to take further steps in the litigation, failing which the summons will lapse.

Nedcor Bank Ltd v Rundle[18]

The court dealt with a case where prescription was interrupted by a claim being filed against a company in liquidation. The court had to decide when the running of prescription restarted.

The court held that the running of prescription of a money debt, after interruption by filing a claim against a company in liquidation, recommences on confirmation by the Master of the company's final liquidation and distribution account.

1.7.2 Suspension of prescription

Certain obstacles suspend prescription from continuing until a period of one year has passed from the date when the obstacle is out of the way. The following are examples of obstacles that suspend prescription:

- The creditor is a minor, an insane person, or a person under curatorship.
- The creditor is prevented from interrupting prescription by an act of God.
- The debtor is outside the borders of South Africa.
- The debtor and the creditor are married to each other, or they are partners and the debt arises from the partnership.
- The creditor is a juristic person and the debtor is a member of the governing board of that juristic person.
- The debt is the subject of a dispute submitted for arbitration.
- The debt is the subject of a claim filed against the estate of a deceased debtor or the insolvent estate of a debtor.

1.8 Insolvency and rehabilitation

A person whose liabilities exceed his or her assets may be declared by the High Court to be insolvent. The process by which the High Court declares a

natural person insolvent is called ‘sequestration’. The term ‘liquidation’ is used for the process applicable to juristic persons.

Certain contracts entered into by an insolvent prior to sequestration may be set aside by the court. The rehabilitation of the insolvent discharges all debts incurred prior to sequestration.[19] Insolvency and sequestration are dealt with in greater detail in chapter 31 in this book.

1.9 Death

As a general rule, the executor of the estate of a deceased person is liable in his or her representative capacity for all contracts for which the deceased would have been liable in his or her lifetime, to the extent of the assets in the deceased estate. Similarly, the executor may claim from others the fulfilment of contracts for the benefit of the estate.[20]

Scoin Trading (Pty) Ltd v Bernstein NO [21]

A collector of gold coins agreed to buy a very valuable coin from a gold dealing company. He paid a deposit and they agreed he would pay the balance by the end of the year. However, he died before the balance was paid.

The court held that the payment of a debt was not impossible because of the death of a debtor, unless the performance was of a personal nature. The court granted the claim for the balance of the purchase price, and interest from 1 January of the next year.

Contractual rights and duties of the deceased will not pass to the executor if these rights and duties are personal, for example:

- Contracts of service.
- Contracts dependent on the skill or scientific knowledge of the deceased.
- Contracts which the parties intended to be performed personally by the deceased.
- In the absence of express provisions to the contrary, contracts of agency terminate on the death of the principal or the agent. The same applies to contracts of partnership.

1.10 Breach of contract

It is necessary for a defaulting party to be in breach of contract before an aggrieved party may choose to cancel the contract. Just because a party refuses or fails to perform as he or she agreed to, does not necessarily mean that the contract was breached. On any failure to perform, the aggrieved party should issue a written notice to the defaulting party demanding that he or she perform properly in accordance with the terms of the contract, failing which they will be regarded as being in breach, and which will then entitle the aggrieved party to choose to cancel or to claim other legal remedies.

A contract may be breached in one of the following ways:[22]

- **Repudiation**: This is the refusal by one party, either in words or by conduct expressly or by implication, to carry out his or her obligations. This refusal entitles the aggrieved party either to accept the repudiation and to treat the contract as terminated and claim damages for losses suffered, or to refuse to accept the repudiation and insist on performance.[23]

  The analogy of offer and acceptance has previously been used in relation to repudiation.[24] It created the impression that repudiation consists of two parts, namely the act of repudiation by the guilty party and the act of the innocent party 'accepting' and thus completing the breach.

  This is a wrong statement of our law. The correct view is that repudiation in itself is a breach of contract. The 'acceptance' by the innocent party is merely a convenient catch phrase, but does not complete the breach. It simply refers to the exercise by the innocent party of its rights to terminate the agreement.[25]

  The test for repudiation is objective: the emphasis is not on the repudiating party's state of mind. It is not dependent on what he or she subjectively intended, but on what someone in the position of the innocent party would think he or she intended to do. Repudiation is therefore not a matter of intention, but of perception. The test for repudiation is whether a reasonable person would conclude that proper performance would not be forthcoming from the repudiating party.

If the Consumer Protection Act[26] applies to the particular transaction, then no matter what fixed-term is stated in the contract, a buyer who is a natural person may cancel a fixed-term contract before its expiry by giving the seller 20 business days' notice in writing. The buyer will not be in breach of contract. The seller will be entitled to any outstanding amount owed, as well as a reasonable cancellation fee. What is 'reasonable' depends on the amount owed; the value of the transaction up to the date of cancellation; the value of the goods; the duration of the consumer agreement; the losses suffered or benefits accrued by the buyer; the length of notice of cancellation provided by the buyer; the reasonable possibility for the seller to find an alternative buyer; and the general practice of the relevant industry.

- **Anticipatory breach**: The party refuses to perform before the time required for him or her to perform. The debtor makes it known that he or she will not perform on the due date. It is then not necessary for the creditor to wait until the due date for performance. He or she may proceed as if the breach of contract had already occurred. An anticipatory breach amounts to a breach of the contract in advance.
- **Default by the debtor**: This is also known as *mora debitoris*. Where there is wrongful late performance or failure to perform the contract within the proper time, the debtor is in default. Performance must be due and possible, the creditor must have a valid right to claim performance, and the debtor must have no defence for the failure.

There are two kinds of failure by the debtor to perform the contract within the proper time:

- **Debtor's failure to perform within a reasonable time**: This is also known as *mora ex persona*. Where there is no time for performance specified in the contract, the debtor should perform within a reasonable time. What is reasonable depends on the circumstances known or foreseen by the parties at the time the contract was entered into. Once the debtor fails to perform by the end of a reasonable time, the creditor may then demand performance within a stated period. This period should also be reasonable. The demand may be oral or written. Once the debtor fails to perform within the time demanded, he or she is in default. The creditor then may choose to cancel the contract.[27]

- **Debtor's failure to perform within a specified time**: This is also known as *mora ex re*. Where a time period for performance is specified in the contract and the debtor fails to perform within that time, the debtor is automatically in default. No more steps are required to place the debtor in default.[28]

  Normally a creditor may cancel the contract if a 'forfeiture clause' has been included in the agreement. This type of clause is also known as a *lex commissoria*. Typically this type of clause allows a creditor to keep what was received from a debtor if the agreement is cancelled. The effect of a forfeiture clause may be alleviated under the Conventional Penalties Act.[29]

  Even in the absence of a forfeiture clause, the creditor may be entitled to cancel the contract if he or she can show that 'time is of the essence', that is, that time was essential to the successful carrying out of the contract.

  It is not sufficient just to state a date by which a party 'shall' or 'must' perform its obligations; generally the parties must state in the contract that time would 'be of the essence'. However, it is sometimes possible for the court to find that time was of the essence if the nature of the contract and the surrounding circumstances required that an implied or tacit term had to be read into the agreement.
- **Default by the creditor**: This is also known as *mora creditoris*. In some contracts the creditor is required to cooperate with the debtor to enable the debtor to perform. Default by the creditor occurs where the creditor unjustifiably refuses or delays assistance as required and this obstruction prevents the debtor from performing in terms of the contract. For example, a contract provides that the creditor must make space available in a warehouse to accept delivery of goods, and the creditor does not do so. The creditor is not able to deny that the debtor failed to perform in time because of the creditor's lack of cooperation.[30]
- **Positive malperformance**: There are two categories of positive malperformance:
  - **One party commits an act he or she agreed not to do**: This act must be material to entitle the aggrieved party to cancellation. The only other way to cancel a contract in these cases is where it is

expressly stated in the contract that a particular act entitles cancellation, whether or not it is material.

- **One party performs defectively**: The performance of an essential term of the contract must have been defective. A term of the contract will be considered essential if, without it, the other party would not have entered into the contract.[31]

- **Prevention of performance**: This form of breach arises where one party does something that effectively prevents himself or herself, or the other party, from performing. The breach can arise through intentional or negligent conduct. This type of breach is also known as 'frustration of performance'.

1.11 *Rouwgeld* clause

A contract may contain a provision entitling a party to get out of the contract on the payment of a sum of money. For example, by forfeiting a deposit that had been paid. This provision is known as a *rouwgeld* clause, or a *roukoop* clause in the law of sale.[32]

1.12 Cooling-off provisions

To protect inexperienced buyers from being pressurised into entering into contracts, certain contracts may be terminated at the instance of one of the parties within five days of the agreement. This five-day period is called the 'cooling-off' period. It is irrelevant for the calculation of the cooling-off period when the seller signs the agreement.

Contracts that contain cooling-off periods include:

- Lease agreements and instalment sale agreements (see the section on the National Credit Act[33] in chapter 16 in this text dealing with the law of sale).
- Sale of land: The Alienation of Land Amendment Act[34] provides that agreements for the sale of land for residential purposes for a price of less than R250 000 must contain a cooling-off clause allowing the buyer to terminate the agreement within five days from the date of signing any agreement. The five days are calculated excluding the day the agreement

is signed by the purchaser and any Saturday, Sunday or public holiday. The cooling-off period does not apply where the purchaser is a juristic person, where the land is bought by auction, or where the buyer exercises an option to purchase land five days or more after the option was given by the seller.

- To terminate the agreement, the buyer must deliver a written, signed unconditional notice to the seller or the seller's agent within the cooling-off period. All amounts paid must be refunded in full to the purchaser within ten days of delivery of the notice of termination.
- Goods bought through direct marketing: The Consumer Protection Act[35] applies to all agreements which result from direct marketing where a consumer is a natural person, or a juristic person with an annual turnover of less than R3 million. These agreements are subject to an automatic cooling-off period. The consumer must return the goods to the supplier within five business days from the time the agreement was entered into, or from the time the goods were delivered. A supplier must refund the purchase price of the goods within 15 business days from receipt of the consumer's notice, or the return of goods, whichever is the later.

2 Remedies

The courts will not allow a party to escape his or her obligations under a contract by simply breaking it. If one party fails to comply with the terms of an agreement, the aggrieved party may be entitled to cancel the contract, but only under certain circumstances. Whether the aggrieved party is entitled to cancellation depends on whether or not the breach is an essential term of the contract, that is, a fundamental breach going to the root of the contract.

If the breach is material, the aggrieved party can choose to cancel the contract or keep to it. If he or she cancels, both parties are relieved of their obligations and the aggrieved party may claim damages. If the aggrieved party does not cancel, he or she must still perform his or her obligations but may claim damages or ‘specific performance’, which is a court order to force the party at fault to comply with his or her part of the contract.[36]

This text will examine four types of remedies that might be available to an aggrieved party.

2.1 Specific performance

A party who is prepared to perform in terms of the contract may demand that the other party perform their side of the agreement. ‘Specific performance’ is a court order forcing the debtor to perform in terms of the contract. The court order is enforceable by proceedings for contempt of court if the debtor does not. Alternatively, the court may order payment of damages. The remedy is always subject to the court's discretion.[37]

Specific performance will generally not be granted in any of the following situations:

- Where it is impossible for the debtor to perform their side of the agreement.
- Where damages would be an adequate form of compensation or remedy.[38]

- Where it would be inequitable or unfair to the defendant or to a third party.[39]

> ***Haynes v Kingwilliamstown Municipality*** [40]
>
> The municipality entered into a contract with the owner of land regarding the provision to him of water from a river. If the municipality continued to supply him with the same amount of water after a severe drought, residents of the town would have been very harshly affected. The municipality refused to honour the agreement.
>
> The court found that an order of specific performance would have caused hardship to the inhabitants and refused to order the municipality to comply with the agreement.

- Where performance would involve a personal relationship between debtor and creditor. For example a contract of service.

A person who sues for breach of a contract in terms of which he or she has not fully performed, will be met with the defence that he or she must perform first before requiring the other party to perform. This is known as the 'principle of reciprocity',[41] or, in Latin, the defence is known as the *exceptio non adimpleti contractus*.

> ***Motor Racing Enterprises (Pty) Ltd (in liquidation) v NPS (Electronics) Ltd*** [42]
>
> An electronics company agreed to sponsor the Grand Prix being organised by another company. The parties agreed on the obligations of sponsorship, and payment of the sponsorship fee. When the sponsor was sued by the organisers for the balance of the sponsorship fee, it claimed that there had been numerous breaches by the organisers of the sponsorship undertakings, and it raised as a defence the principle of reciprocity: the organisers had to perform first before compelling the sponsor to perform.
>
> The court found in favour of the sponsor, and held that the parties had intended that the obligations of the sponsorship to be reciprocal with the sponsor's obligations to pay the fee. The sponsor did not have to pay the balance of the fee to the organisers.

The principle of reciprocity can result in unfairness. For example, where a creditor has performed defectively but that performance is being used by the debtor. Our courts may then relax the principle of reciprocity so as to allow creditors to recover a reduced amount, provided the following can be proved:

- The debtor is using the defective performance.
- The court believes that circumstances exist for it to use its discretion to grant the creditor reduced payment.

- The amount of the reduced payment can be proved.[43]

Where the defective performance cannot be rectified or the value of the performance quantified, then the court may make its own formula to ensure fairness to both parties.[44]

2.2 Interdict

This is an order from the court prohibiting some action and is enforceable by contempt proceedings. Sometimes it is used to enforce restraint of trade agreements.[45]

An applicant for an interdict must prove the following three requirements before a court will grant the interdict:[46]

- A clear right.
- An injury actually committed or reasonably apprehended.
- The absence of similar protection by any other ordinary remedy.

2.3 Cancellation and damages

In the absence of a specific cancellation clause entitling an aggrieved party to cancel a contract, or where there has been a failure to perform timeously in circumstances where time is of the essence of the contract, the aggrieved party only may cancel if there has been a breach of an essential term.

Where the breach is of an essential term, the aggrieved party is entitled to cancel the contract and claim damages. Where the breach is not of an essential term, he or she is entitled to damages only. The measure of damages is the same in both cases, that is, what is necessary to put the plaintiff in the position he or she would have been in had the contract been properly performed.

In determining the damages to be awarded, the plaintiff must prove the following:

- **The loss must have been a natural and direct consequence of the breach**.
- **The loss must have been within the consideration of the parties**: The test is one of remoteness. The loss must not be too remote. The liability of the guilty party will be limited to the loss foreseen by him or her (and not the loss foreseen by the parties) at the time of the contract (not at the time of the breach), or the loss that ought to have been foreseen by a reasonable person in the debtor's position at the time of the contract.[47]
- **The loss must be measurable in money**:
  - Monetary loss incurred.
  - Monetary gain not made.
  - In terms of our law of contract, no contractual claim may be made for anything other than financial loss. No award will be made for loss of comfort, pain and suffering, humiliation, annoyance or disappointment. Claims for these factors can only be made under a delictual action, and not an action based on the contract.[48] Delictual actions are discussed in more detail in the web-based text in chapter 37 on the law of delict.

Administrateur, Natal v Edouard [49]

A woman was meant to have a sterilisation procedure while having a caesarian for the birth of her child. The surgeon forgot; the woman later fell pregnant and gave birth to another child. The hospital was sued for damages arising from breach of contract for discomfort, pain, and suffering, and loss of amenities of life as a result of the child's birth.

The court held that damages for losses can only be financial, and that non-pecuniary losses could not be sued for in an action based on contract.

- **The plaintiff must prove his or her damages**: The plaintiff only can sue for actual monetary or pecuniary loss already suffered or which will be suffered in the future. It is a principle of our law that the plaintiff can sue only once per cause of action. In any one court case, however, it is possible to have several claims relating to the same cause of action. The plaintiff must therefore calculate carefully the extent of what he or she wishes to claim before going to court.
- **The plaintiff attempted to mitigate the loss**: The plaintiff must attempt to reduce the loss suffered as a result of the defendant's breach. This is known as mitigating the loss. The plaintiff must take all the steps a reasonable person would have taken to minimise or mitigate the loss. If, for example, the plaintiff's motor vehicle has been damaged in a collision, he or she must take the bus to work or hire a replacement motor vehicle to minimise the claim for loss of earnings due to the accident.[50]

2.4 Penalty clauses

In terms of the Conventional Penalties Act[51] any clause in a contract providing for the payment of a sum of money in the event of a breach of the contract is deemed to be a penalty clause and may be enforceable if it is not unreasonable.

The court may reduce the penalty if it is disproportionate to the prejudice suffered by the creditor. The debtor bears the onus of proving that the penalty clause is unreasonable in view of the damages actually suffered. If the debtor fails to prove this, the full penalty is payable.[52]

Steinberg v Lazard [53]

The parties entered into a written agreement of sale in terms of which one sold to the other the member's interest in a close corporation. The agreement contained a penalty clause.

The court held that a creditor who claims payment of a penalty as defined in the Conventional Penalties Act [54] is required neither to allege nor to prove prejudice in order to escape a reduction of the penalty. Rather it is for the debtor to allege and prove an absence of prejudice suffered by the creditor.

Creditors must choose whether to claim the penalty or claim ordinary contractual damages. The court will not allow them to claim both.[55]

PRACTICALLY SPEAKING

Things to watch for in contracts[56]

The two greatest contributors to contract disputes are the failure to address all possible situations, whether deliberately or not, and ambiguity in the provisions that are included. Leaving key items (for example, price or delivery dates) open for later discussion may well make the contract unenforceable if the two sides cannot later reach agreement. Similarly, not addressing all possibilities, even the unlikely ones, can lead to problems if those possibilities occur. (Everyone may believe that a key piece of third-party software will be ready well in advance of when needed, but what happens if it is not?) A provision that is ambiguous can lead to arguments, especially where each side has mentally interpreted the provision in its favour.

These problems are what lead to the saying, ‘get it in writing’. Although oral contracts are usually valid, there can be huge problems proving their terms. This is also a good reason for using plain English and, avoiding legal language. Using someone else's contract can bring its own problems if that contract has provisions that do not apply to your situation or if it does not address all the issues you face. (Also, any form of contract needs to be allowed to change over time as business conditions change and you gain additional experience in the sorts of problems that are likely to arise.)

With that background, we can look at some more specific contractual provisions. While there is not space here to delve into particular types of contracts – like those involving licences, employment, leases, consumers, confidentiality, there are certain clauses that are useful in most contracts.

- **Performance**: Specify exactly what each party is to do and when. If there is what might be an open-ended commitment (for example, a flat-fee per month consulting arrangement), specify the maximum number of hours that will be provided. Be sure to state exactly when payment is due and what happens if payment is not made on time. If you are the party receiving payment, you may well want to add a late charge or interest for overdue payments. In situations where you are receiving a percentage, it is generally wise to include a provision allowing an audit of the books.
- **Competition**: Where you are concerned about the other side having access to your confidential information, you will likely want to include confidentiality provisions that prohibit the other party not only from transmitting the information to others, but also from using that information for purposes other than those set out in the agreement.
- **Termination**: For the party purchasing goods or services, a termination provision can often be the best protection when a contractual relationship is not working well.

Ideally, termination should be allowed at any time upon giving the required notice (for example, 90 days). Be wary of provisions that allow termination only once a year during a ‘window’ period. Finally, you may well want to state that certain provisions – confidentiality, outstanding payments, etc. – remain in effect despite any termination of the main agreement.

- **Exposure**: Any party providing goods or services needs to consider adding provisions that limit warranties. With contracts of sale, the law creates certain warranties unless there are specific disclaimers of those warranties. Some of these warranties – such as the warranty of fitness for the buyer's purpose – may be difficult for the seller to meet. Warranties can also be a problem for parties providing services. In addition, a party providing services or goods may want to include a provision limiting liability so that there is no exposure for the other side's lost profits in the event of a problem.
- **Changes**: Certain provisions limiting changes in an agreement can be useful. For example, unless the contract states otherwise, either side has the right to assign the contract. You may want to prevent assignment to a competitor or prevent all assignment so that you are assured of who you will be dealing with. Generally, any ambiguity in an agreement is construed against the party drafting it. One possible solution is to add a provision stating that the agreement will be interpreted as if drafted by both parties equally.
- **Integration**: Another useful provision is an ‘integration’ clause. This type of clause states that the contract sets out the entire agreement between the parties and that no oral representations or earlier versions of the contract apply. Obviously, this can eliminate a great deal of argument by limiting the agreement to the terms of the contract itself. Similarly, you may want to include a provision stating that any modifications of the agreement must be in writing and signed by both parties, to eliminate any future claim that there was an oral modification to the agreement that you dispute.
- **Enforcement**: If you believe it is more likely that you would sue (rather than be sued) over the contract, you may well want to include a provision allowing recovery of all attorneys' fees.
- **Domicile**: A clause of this nature involves the parties selecting the physical address at which any notices or legal processes can be delivered. A document or process properly delivered to a chosen domicile is presumed to have been received by the party who selected that domicile, and that party cannot deny having received it.

  Particularly where the two parties are from different countries, it is important to specify which country's law will apply and where any litigation will be held. One way to resolve potential disputes is to state that the party suing has to sue where the defendant is located. However, this is not appropriate for all agreements.
- **Dispute resolution**: Arbitration clauses are something else to keep in mind. Arbitration can be cheaper and faster than litigation. Arbitration is particularly useful in a relatively small industry or where the parties are likely to be doing business again in the future. Mediation is another option that can be used with or without an arbitration clause. Matters that are mediated are often settled. The disadvantage is that if the matter does not settle, you still have the cost of arbitration or litigation.

THIS CHAPTER IN ESSENCE

1 The most common way that contracts end is simply through performance.
2 For set-off to operate, the debts must be due between the same parties in the same capacities; both debts must be of money or movable property of the same kind; the debts must be liquid; and both debts must be unconditional, due, and payable.
3 In terms of the Prescription Act, it is possible to acquire rights, or be released from obligations, simply by the passing of time. Most debts or claims are extinguished after three years, unless prescription is interrupted or suspended.
4 Repudiation is the refusal by one party, either in words or by conduct expressly or by implication, to carry out his or her obligations. If the refusal to perform occurs before the time required for the party to perform, it is known as anticipatory breach.
5 Where there is wrongful late performance or failure to perform the contract within the proper time, the debtor is in default which is also known as *mora debitoris*. There are two types: Where the debtor fails to perform within a reasonable time, this is also known as *mora ex persona*. Where the debtor fails to perform within a specified time, this is also known as *mora ex re*.
6 Default by the creditor occurs where the creditor unjustifiably refuses or delays assistance as required and this obstruction prevents the debtor from performing in terms of the contract. This is also known as *mora creditoris*.
7 Breach can also occur through positive malperformance, or prevention of performance.
8 Specific performance is a court order forcing the debtor to perform in terms of the contract.
9 Specific performance will generally not be granted where it is impossible for the debtor to perform their side of the agreement; damages would be an adequate form of

compensation or remedy; where it would be inequitable or unfair to the defendant or to a third party; or where performance would involve a personal relationship between debtor and creditor.

10 Where the breach is of an essential term, the aggrieved party is entitled to cancel the contract and claim damages. Where the breach is not of an essential term, he or she is entitled to damages only. The measure of damages is the same in both cases, that is, what is necessary to put the plaintiff in the position he or she would have been in had the contract been properly performed.

QUESTIONS

Short questions (1–5 marks)

1. What is meant by ‘waiver’?
2. List three types of novation.
3. What is ‘merger’?
4. List two types of prescription.
5. What is anticipatory breach?

Paragraph questions (5 marks)

1. Discuss the role of impossibility of performance in the termination of contracts.
2. Discuss how set-off operates.
3. Discuss the operation of extinctive prescription.
4. What is the effect of death on contracts previously entered into?
5. What is a cooling-off period?
6. Discuss the remedy of specific performance for breach of contract.
7. Discuss the remedy of damages for breach of contract.

Essay questions (10 marks)

1. Write notes distinguishing between acquisitive and extinctive prescription.
2. Discuss five forms of breach of contract.

Problem questions (20 marks)

1. On 1 March, Amanda sells her house to Bobby for R100 000. The written contract is subject to the condition that Bobby gets a loan from Big Bucks Bank. On 2 March, Bobby sees a much nicer house for only R80 000. He decides that he would much rather buy that house. Can Bobby get out of his contract with Amanda by simply not bothering to apply to Big Bucks Bank for the loan? Discuss.
2. Zelda and Nico enter into a written contract in terms of which she sells her house to him for R100 000. The contract is valid and binding. The day after the contract was concluded Justin approaches Zelda and offers to buy the same house for R110 000. Zelda wants to accept the offer and tells Nico that she is not giving him the house. What is Nico's legal position?
3. Jezza spends more time partying than studying, so he promises to pay Smarty R5 000 to write his university business law assignment for him. Smarty does the work and gives the completed assignment to his friend, Albert, to send by email. Albert is a very hard working student and thinks that Smarty and Jezza are being immoral. Albert tells Smarty that he will email the assignment to Jezza, but secretly he does not do this. Jezza finds out later that he has failed the year, and he gets thrown out of university before finishing his degree. Advise Jezza, Albert and Smarty of their legal situations and their remedies.
4. Natalie claims R10 000 from Owen arising from an alleged contractual debt. Owen posts Natalie a cheque for R7 500 together with a letter stating that the amount is in full and final settlement of Natalie's claim. Discuss.
5. Stan sells his house to Ben. The contract is subject to the suspensive condition that Ben has to obtain a bond for the full purchase price within two weeks. Discuss the following legal situations:
    a. Ben fails to apply for the bond.
    b. Ben applies to five building societies, which all refuse the bond.
    c. Ben obtains the bond, but Stan says he now has nowhere else to go and he cannot let Ben have the house.

d. Ben subsequently agrees to pay cash for the house.

6. Aaron is 17 years old and falls in love with Beauty, who is 18 years old. They get married secretly by an Elvis Presley impersonator in Las Vegas, while on holiday in the United States of America. Aaron's grandfather is Charles, who is 73, and very jealous of Aaron. Charles arranges to have Beauty murdered to teach Aaron a lesson. Things go terribly wrong, and Aaron is killed instead. Advise Beauty and Charles of their legal positions.
7. Dopey signs an employment contract. On his way home he is hit by a car and lies in a coma for 40 years. When he wakes up he finds a copy of the employment contract and immediately demands that the company pay him 40 years' wages. Advise the company.
8. Mo agrees to buy Zola's car for R10 000. Zola agrees to give him the keys and the registration documents in one week. Meanwhile, Mo's friend Constance tells Mo she will pay him R20 000 if he transports a 5 kg package for her once he has the car. Mo pays Zola and gets the car, collects the package and is paid the R20 000 by Constance. He is transporting the package in the car when he is stopped by the police. It turns out that the car is stolen and the package contains dagga. Advise Mo, Constance and Zola of their legal remedies.

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1 Fouché, 125–126; Gibson, 104–107; Swanepoel et al., 62–64.

2 Fouché, 129; Gibson, 104–115; Havenga, 114; Sharrock, 220; Swanepoel et al., 64–65.

3 Havenga et al., 115; Gibson, 112–113; Sharrock, 220; Swanepoel et al., 65.

4 *Grootschwaing Salt Works Ltd v Van Tonder* 1920 AD 492; Fouché, 128; Gibson, 111; Havenga et al., 116; Sharrock, 526; Swanepoel et al., 66.

5 *Grootschwaing Salt Works Ltd v Van Tonder* 1920 AD 492.

6 *Peters Flamman and Company v Kokstad Municipality* 1919 AD 427; *Bekker NO v Duvenhage* 1977 (3) SA 884 (E); Fouché, 130; Gibson, 56–58; Sharrock, 527–531; Havenga et al., 75–82.

7 *Peters Flamman and Company v Kokstad Municipality* 1919 AD 427.

8 *Hersman v Shapiro and Company* 1926 TPD 367.

9 Ibid.

10 *Benjamin v Myers* 1946 CPD 655.

11 Ibid.

12 Fouché, 128; Gibson, 109–111; Havenga et al.,116–117; Sharrock, 526–527; Swanepoel et al., 66–67.

13 *Altech Data (Pty) Ltd v MB Technologies (Pty) Ltd* 1998 (3) SA 748 (W).

14 Prescription Act 68 of 1969.

15 Fouché, 126–127; Gibson, 107–109; Havenga et al., 118–120; Sharrock, 531–532, 684–685; Swanepoel et al., 67.

16 *Van Zijl v Hoogenhout* [2004] 4 All SA 427 (SCA).

17 *M Deysel v Dr R Truter and another* (C) (case 2752/2000 unreported).

18 *Nedcor Bank Ltd v Rundle* 2008 (1) SA 415 (SCA).

19 Fouché, 129–130; Gibson, 113–114; Havenga et al., 120; Sharrock, 631–638; Swanepoel et al., 68.

20 Fouché, 130; Gibson, 114–115; Sharrock, 536.

21 *Scoin Trading (Pty) Ltd v Bernstein NO* 2011 (2) SA 118 (SCA).

22 Fouché, 113–118; Gibson, 92–104; Havenga et al., 97–110; Sharrock, 538–555; Swanepoel et al., 70.

23 *Novick v Benjamin* 1972 (2) SA 842 (A); *Tuckers Land and Development Corporation (Pty) Ltd v Hovis* 1980 (1) SA 645 (A).

24 *Nash v Golden Dumps (Pty) Ltd* 1985 (3) SA 1 (A) at 22D–F.

25 *Datacolor International (Pty) Ltd v Intamarket (Pty) Ltd* 2001 (2) SA 284 (SCA).

26 Consumer Protection Act 68 of 2008.

27 *Nel v Cloete* 1972 (2) SA 150 (A); *Ver Elst v Sabena Belgian World Airlines* 1983 (3) SA 637 (A).

28 *Goldstein and Wolff v Maison Blanc (Pty) Ltd* 1948 (4) SA 446 (C).

29 Conventional Penalties Act 15 of 1962.

30 *McCabe v Burisch* 1930 TPD 26.

31 *Algoa Milling Company v Arkell and Douglas* 1918 AD 17.

32 Havenga et al., 93–94.

33 National Credit Act 34 of 2005.

34 Alienation of Land Amendment Act 103 of 1998.

35 Consumer Protection Act 68 of 2008.

36 Fouché, 119–124; Havenga et al., 103–110; Sharrock, 547–555; Swanepoel et al., 74–80.

37 *Farmers' Co-op Society v Berry* 1912 AD 350.

38 Ibid.

39 *Haynes v Kingwilliamstown Municipality* 1951 (2) SA 372 (A).

40 Ibid.

41 *SA Wood Turning Mills (Pty) Ltd v Price Brothers (Pty) Ltd* 1962 (4) SA 263 (T); *BK Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 (1) SA 391 (A).

42 *Motor Racing Enterprises (Pty) Ltd (in liquidation) v NPS (Electronics) Ltd* 1996 (4) SA 950 (A).

43 *BK Tooling (Edms) Bpk v Scope Precision Engineering (Edms) Bpk* 1979 (1) SA 391 (A).

44 *Thompson v Scholtz* 1999 (1) SA 232 (SCA).

45 *Roberts Construction Company Ltd v Verhoef* 1952 AD 107.

46 *Huey Extreme Club v McDonald t/a Sport Helicopters* [2004] 3 All SA 702 (C).

47 *Victoria Falls and Transvaal Power Company Ltd v Consolidated Langlaagte Mines Ltd* 1915 AD 1.

48 Sharrock, 544–546.

49 *Administrateur, Natal v Edouard* 1990 (3) SA 581 (A).

50 *Hazis v Tvl and Delagoa Bay Investments Co Ltd* 1939 AD 372; *North and Son (Pty) Ltd v Albertyn* 1962 (2) SA 212 (A).

51 Conventional Penalties Act 15 of 1962.

52 *Van Staden v Central South African Lands and Mines* 1969 (4) SA 349 (W).

53 *Steinberg v Lazard* 2006 (5) SA 42 (SCA).

54 Conventional Penalties Act 15 of 1962.

55 Fouché, 123; Gibson, 103–104; Havenga et al., 91–93; Sharrock 551–553; Swanepoel et al., 79–80.

56 Source: http://www.methvenlaw.com/n_contracts.htm, accessed 25 August 2008. Copyright 1996–2009 Bruce E. Methven. All rights reserved.

PART C: SPECIFIC BUSINESS CONTRACTS

What contracts will my business need?

CHAPTER 16 Sale – *How can I protect myself when I buy or sell things?*

CHAPTER 17 Credit agreements – *How do I decide whether to grant credit or not?*

CHAPTER 18 Lease and occupancy – *What clauses should I be careful of when signing a lease?*

CHAPTER 19 Insurance – *How do I protect my business against accidents, thefts, or damage?*

CHAPTER 20 Real and personal securities – *How do I guarantee that you pay me?*

CHAPTER 21 Negotiable instruments and other forms of payment – *Is it smarter to pay by cheque or credit card?*

Chapter 16

Sale

'When I was young I thought that money was the most important thing in life; now that I am old I know that it is.'

OSCAR WILDE (1854–1900)
IRISH WRITER AND POET

What is covered in this chapter

1 Definition
2 Formalities
3 Essential elements
4 Sale distinguished from other transactions
5 Duties of the seller
6 Duties of the buyer
7 Special sales
8 Ownership
9 Warranties
10 Remedies available to the buyer
11 Remedies available to the seller

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

As consumers we buy things every day – from food to clothing, and from stationery to motor cars. Businesses buy supplies and sell goods and services to customers. Whether it is for cash or credit, the law of sale plays a huge role in our daily lives.

Most people are therefore very surprised when they learn it is legal to sell something one does not own. This is because ownership and possession are two different rights, and can pass at different times when a thing is sold. For example, one person can possess and keep a car in their garage and drive it every day, while another person actually owns it. The rights and duties of a seller and a buyer are important to understand, because sometimes the agreement to sell the thing can go wrong. The seller might not deliver the thing, it could be defective, or the buyer might refuse to pay the full purchase price. What are one's rights if the thing is damaged or destroyed before it is given to the buyer? There are many areas where knowledge of the law of sale is relevant to you.

1 Definition

A sale is a contract in which a seller promises to deliver a thing to a buyer who agrees to pay a certain price.[1]

2 Formalities

A valid contract of sale needs no formalities, except for the following:[2]

- **Sale of land**: In terms of the Alienation of Land Act,[3] an agreement to sell land or any rights over the land must be in writing and signed by both parties. All material terms must be included or else the contract is void. The court will not make a contract for the parties where their intention is not ascertainable from the contract itself.

> ***Just Names Properties 11 CC and another v Fourie and others*** [4]
>
> Several parties entered into an agreement to sell immovable property. At the time the contract was made the parties had not yet agreed on the terms relating to occupational rent. The plaintiff's representative then suggested that the sellers sign two blank pages and that he would later insert the terms agreed upon.
>
> The court had to consider whether signature on a blank page in a contract for the sale of land made the agreement invalid. It held that where the terms of the contract were required by statute to be included in a document and signed by a particular party to show agreement with the terms, the later insertion of these terms after signature on a blank piece of paper could not constitute compliance.

- **Credit agreements**: In terms of the Credit Agreements Act,[5] a credit agreement must be in writing and signed by both the buyer and the seller. If this is not done the contract is still valid but the credit grantor can be fined, or, in serious cases, imprisoned.
- **Sale of an insolvent business**: In terms of the Insolvency Act,[6] if a business is sold due to insolvency then a notice of the sale must be printed in the local press and the *Government Gazette*. Failure to do so does not mean that the sale is void, but that the trustee of the insolvent estate can reverse the sale.
- **Express agreement**: The parties may agree between themselves to any conditions to govern the sale. For example, they may agree that there is no binding contract until the agreement is put in writing and signed by both parties.

3 Essential elements

To decide if a sale has been concluded, a court will examine whether the parties have agreed on the following three essential elements.

3.1 Agreement to deliver

Legally, an agreement to sell something does not mean that ownership of the thing being sold is transferred from the seller to the buyer. A valid contract of sale only gives the buyer a personal right to force the seller to deliver the thing so that the buyer can take possession of it. Until delivery, the buyer has no right in the thing itself.

Legal rights and duties arise once there is an agreement to sell. For example, the duty to pay, or to deliver the thing being sold. For a contract of sale to be complete legally which is a stage known as *perfecta*, it is not necessary that the price was paid, or that the thing was delivered.

This very important concept has relevance for the passing of risk and the passing of ownership. Legally, it is only necessary for the parties to agree to exchange the thing being sold for the agreed price for the contract of sale to be complete.

3.2 Agreement on the identity of the thing to be sold

The parties must agree on the identity of the thing being sold. The thing being sold can also be called the *merx*.

As a general rule, anything can be sold, even something that does not yet exist, or that does not belong to the seller.[7]

Certain things that already exist may not be sold:

- A right of inheritance from a person still alive.
- Public properties. For example, parks.
- Things that are restricted for sale by laws. For example, firearms and poison.
- Things that cannot be owned. For example, the sea, the air, and outer space.

The thing being sold does not need to be in existence at the time of the contract, provided that there is a possibility of its future existence. For example, it is legal to buy a car that has not yet been manufactured. What is being sold is the expectation that the car will in fact be delivered, even though it does not exist at the time the contract was entered into.[8]

The ‘hope of a thing’ is the seller's expectation of the thing existing in the future. The buyer takes the risk that the thing being sold will be of an inferior nature, or that it might never come into existence at all. For example, where a speculator buys a future harvest that has not been planted yet, he or she must pay the full purchase price even if the harvest fails.

There will be a valid contract of sale even where the thing being sold does not belong to the seller. A contract of sale does not guarantee that the seller is the owner, or that ownership of the thing will be transferred to the buyer. All that is sold is an implied warranty that the buyer will have free and undisturbed possession of the thing once it is delivered.[9]

Where the seller innocently sells a thing not belonging to him or her without knowing that it belongs to another person (for example stolen property), the buyer must keep to the contract until the ‘true owner’ threatens to take the thing back. In legal terms the buyer must comply with the terms of the contract until the true owner threatens ‘eviction’, which would ‘dispossess’ the buyer from the right to use and enjoy possession of the thing. Only then may the buyer sue the innocent seller. Where the seller is fraudulent, the buyer can immediately cancel the contract and sue for damages.[10]

3.3 Agreement on the particular price

The parties must agree on the price to be paid, or *pretium*:[11]

- **The price must be certain and consist of money**: The agreement must specify a definite price. A contract to exchange goods is one of barter, and not a contract of sale. Where goods are given in part-payment, the parties must have assigned a monetary value to the goods, and the court will compare the money being paid to the value of the goods. If the goods are worth more than the amount of money, then the court may decide it is a contract of exchange and not a contract of sale.[12]

- **The price must be real and serious**: The transaction must not be a donation disguised as a sale, or be disguised to avoid payment of Value Added Tax (VAT).
- **The price must be fixed or ascertainable**: The parties may fix the price or they must agree on a method of calculation, for example by a third person.

> ***R v Pearson***[13]
>
> The court held that where the seller is a dealer in the goods and has a 'usual charge', it is assumed that the price would be the usual charge.

If the sale is a transaction covered under the Consumer Protection Act[14] and more than one price is displayed at the same time, then the seller can only require payment of the lowest price displayed. A price can be displayed by a label on the article itself, or on a shelf, or be published in a catalogue or brochure.

If the brochure offers a special price until a certain date, then that special price will only be valid until that date. If no date is specified, then the special price will only be valid until a reasonable time after it was published. If the price is covered fully by a second price, then the second price will be the displayed price, and will apply.

If the price is obviously wrong, the seller will not be bound if it corrects the wrong price when it is discovered, and takes reasonable steps to tell buyers of the error and the correct price. A seller will also not be liable if an unauthorised person removes or defaces the correct price. If the seller advertises or displays a discount, then the actual price will be the price on or near the goods, less the discount. However, if the seller has marked the goods with the second, discounted price, then only the discounted price will apply.

4 Sale distinguished from other transactions

The following are not contracts of sale:

- **Barter**: A contract is one of barter if goods are exchanged for other goods.
- **Expropriation**: Expropriation occurs when the State, or a provincial or local authority, forces the sale of land required for public projects or mineral exploration. Expropriation lacks the agreement necessary for a contract of sale.
- **Sale on consignment**: The law of agency governs goods supplied to a seller on consignment.

5 Duties of the seller

5.1 Duty to take care of the thing sold until it is delivered

If the seller negligently damages the thing being sold at any time until it is delivered, then he or she will be liable for the damage. However, the seller will not be liable for any damage caused accidentally. This means that the buyer will suffer any accidental loss or damage to the thing before it is delivered by the seller.

In the law of sale, ‘risk’ refers to the potential for any loss resulting from the accidental damage or destruction of the thing being sold. The risk passes to the buyer as soon as the contract is ‘complete’ or *perfecta*.[15]

For a sale to be complete the following requirements must have been met:

- The particular price must have been fixed.
- The particular thing being sold must have been identified, and, if necessary, set aside or counted out.
- Any suspensive condition must have been fulfilled.

Risk can pass at a different time to when ownership passes. There are several situations in which risk does not pass immediately:

- **Agreement**: Where there has been express or implied agreement between the parties that risk will not pass immediately.[16]
- **While the goods are in transit**: While the seller delivers goods to an address nominated by the buyer, the risk in transit is borne by the seller.
- **Delivery on a specified, certain date**: If the contract says that delivery can take place only on a certain date, then the risk will pass from the seller to the buyer only when the seller delivers on the agreed date.
- **Delivery to an address of the buyer**: If there is an agreement that the seller must deliver the goods to an address nominated by the buyer, then the risk will pass from the seller to the buyer only when the seller delivers to that agreed address.

- **Suspensive condition**: Performance of the contract is delayed until a future event happens. The contract is not complete until the condition is met, and, as a result, the risk will not pass until then. The contract is valid and enforceable, but the risk stays with the seller until the condition has been met. Once the condition has been satisfied, the buyer and the seller are deemed to have acquired obligations with retrospective effect as at the time of the agreement was entered into. That means the risk is deemed to have been transferred at the time the contract was entered into, and not at the time the condition was fulfilled.[17]

> ***Equistock Group CC t/a Autocity Motor Holdings v Mentz***[18]
>
> The court held that where an agreement of sale in respect of a motor vehicle was made subject to a suspensive condition, and the purchaser of the vehicle did not fulfil the suspensive condition because he stopped payment of the cheque that he gave to the seller in part payment for the vehicle, the vehicle remained the property of the seller.

If, pending the fulfilment of a suspensive condition, the thing being sold is totally destroyed, the seller is not entitled to the price and the sale is void. Where the thing is damaged during this time, the risk will be borne by the seller if the suspensive condition was never fulfilled, and by the buyer if it was fulfilled.[19]

If the buyer deliberately tries to prevent the fulfilment of the suspensive condition so that the contract never comes into existence, the law applies the doctrine of fictional fulfilment of condition. This means that the court will pretend that the condition was in fact fulfilled, despite the fact that this was not the case.

The situation is different where the sale is subject to a resolutive condition. Here the risk passes immediately to the buyer. If the thing being sold is destroyed before the fulfilment of the condition, the loss is borne by the buyer.[20]

- **Where goods still must be set aside, or identifed, to fix the price**: The contract is not yet complete and the risk remains with the seller until the thing being sold has been determined and the counting is completed.
- **Sale by measurement or quantity**: Counting is required to determine the price. For example, 500 grams of gold.

- **Sale of a standard item**: Counting is required to separate the purchased material from a greater quantity of the same material in the seller's possession. For example, 20 bags of coal at a certain price per bag, to be appropriated from a pile of hundreds of bags.[21]

> ***Poppe, Schunhoff and Guttery v Mosenthal and Co***[22]
>
> A law was introduced requiring the payment of a tax on brandy sold. The law came into effect after the goods had been sold, but before they had been set aside for the purchaser.
>
> The court held that the risk had not yet passed to the buyer and that accordingly the seller was still liable for the tax.

- **The transaction is covered by the Consumer Protection Act**:[23] If the Act applies, then the thing will remain at the seller's risk until the buyer has accepted delivery. The buyer will be deemed to have accepted delivery when he or she communicates acceptance of delivery to the seller; or the buyer does something inconsistent with the seller's ownership of the thing; or the buyer retains the thing for a reasonable period of time without letting the seller know that delivery was rejected.

  Refer to chapter 30 in this text on consumer protection to see which transactions will be covered by the Act, and which will not be covered.
- **Where the seller is in default in delivering the thing being sold**: The default of the seller causes the risk to return from the buyer to the seller. It will be automatically presumed that damage occurring after the default is due to the negligence of the seller. However, this presumption is 'rebuttable'. In other words, it can be disproved if the seller can show that the damage would have occurred even if delivery had been made at the proper time. If this happens then the loss will be borne again by the buyer.

5.2 Duty to deliver the thing being sold to the buyer [24]

The seller must deliver the thing being sold within the time specified. He or she does not have to transport the thing; only hand over effective control of the thing to the buyer.

The seller must place the thing being sold in a deliverable state so that the buyer can take possession of it. Where immovable property is involved, this means that the seller must take care of any outstanding mortgage bond, evict anyone in unlawful occupation, and remove any movables that do not form part of the property.[25] Where moveable property is involved, the buyer will be responsible for any necessary loading or transport.

Delivery may be actual or constructive:

- **Actual delivery**: This is the physical handing of the thing from one person's hand to another's hand, or placing the thing in the effective control of the buyer.[26]
- **Constructive delivery**: This is a fictitious process that the law accepts as equivalent to actual delivery. No physical handing over occurs. South African law recognises five different types of constructive delivery:
  - **Symbolic delivery**: Symbolic delivery is a substitute for actual delivery. The delivery of the symbolical article enables the buyer to exercise physical control over the thing sold. For example, a bill of lading, or a key to a warehouse or a house.
  - **'Delivery with the long hand'**: The seller points out the article to the buyer to enable the buyer to exercise full control over it when the buyer pleases.[27] This is used when actual delivery is difficult or impossible. For example, due to the size of the thing being sold.

    ***Xapa v Ntsoko*[28]**

    Cattle were pointed out and identified by their markings to serve as dowry for a marriage. The cattle were never physically removed at the time as this would have contravened certain Fever Regulations.

    The court held that sufficient delivery had taken place.

- **'Delivery with the short hand'**: This form of constructive delivery occurs where the thing being sold is already in the possession of the person to whom ownership is to be transferred. For example, a person may borrow something and later buy it, but it is already in his or her possession.
- **Attornment**: This occurs when someone with custody of the goods owned by one person (the seller) becomes the custodian of the same

goods for another person (the buyer).[29]

- **Change of possessor's intention**: This occurs when the seller with legal possession of the thing being sold keeps physical control of it but transfers legal possession to another person. This form of constructive delivery is the opposite of delivery with the short hand. For example, a public art gallery sells a painting it owns to a collector of art, who agrees to allow the gallery to continue to display it. It is not necessary for the seller physically to deliver the item. Delivery is constituted by a change in the seller's mental attitude from being the owner of the thing to being a borrower of it.

5.3 Statutory duties of the seller

The Consumer Protection Act[30] creates implied conditions in every transaction to which it applies:

- The supplier must deliver the goods or services on the agreed date, time and place.
- Delivery takes place at the supplier's place of business (and not the supplier's residence).
- The goods to be delivered remain at the supplier's risk until the consumer has accepted delivery.

The buyer will be deemed to accept delivery when he or she communicates acceptance of the goods to the seller; or when the buyer does something inconsistent with the seller's ownership of the goods; or when the buyer retains the goods for a reasonable period of time without letting the seller know that the goods are rejected.

If delivery is made to a different location, or on a different time or date than agreed, the buyer may accept delivery, or demand delivery as per the agreement, or cancel the agreement and treat the goods as ‘unsolicited’. If a larger amount is delivered than agreed, the buyer can reject delivery, or accept the agreed goods and treat the balance as ‘unsolicited’ goods. The goods will only become ‘unsolicited’ if the buyer tells the seller that they were delivered by mistake within 10 business days of the delivery, and the seller does not collect them within 20 business days after that.

Goods that are delivered to the wrong address and clearly addressed to another person only become ‘unsolicited’ goods if the buyer tells the seller and the goods are not collected within 20 business days after that.

The buyer cannot prevent the seller from collecting the goods, and is not responsible to deliver them to anyone else. The buyer is also not liable for any loss or damage to the goods, unless he or she intentionally causes damage.

A person who lawfully is in possession of unsolicited goods may keep the goods or return them at the risk and expense of the seller. A seller may not charge any fee for unsolicited goods or for their delivery, and any buyer who pays may recover their money.

6 Duties of the buyer

6.1 To pay the purchase price[31]

In respect of movable property, the price must be paid on delivery. The price for immovable property must be paid on registration against the title deeds.

Payment must be made in legal tender, which is defined in terms of the South African Reserve Bank Act[32] as follows:

- Any debt may be paid in gold coins and banknotes.
- A debt of up to R50 may be paid in one or two rand coins.
- A debt of up to R5 rand may be paid in 10, 20, and 50 cent coins.
- A debt of up to 50 cents may be paid in coins of up to five cents or less.

Payment may not be made by cheque unless the parties agree. Agreement may be express or implied, such as by the previous conduct of the parties.[33] Generally the right to enforce payment is suspended until the bank meets the cheque or declines it.

If the money is posted, then the debt will not be paid until the money reaches the seller. However, if the seller requests payment to be made by post, then the debt will be paid once the letter is posted in a correctly addressed and stamped envelope.[34] A request for payment by post may be implied, for example if the seller has only given a postal address for communications.[35]

Payment by credit card results in three sets of contractual relationships, between the bank and cardholder, the bank and the supplier, and the supplier and the cardholder. For more information in this regard, refer to chapter 21 on negotiable and other instruments of payment.

Payment by electronic funds transfer is similar to payment by a cheque: the right to enforce payment is suspended until the funds have been received, or the transfer declined.[36]

In respect of international transactions, either party can insist on paying in South African currency. In the absence of an agreement, the rate of

exchange as at the time of payment will be applied. This means that either party could benefit or lose due to a fluctuation in the exchange rate.[37]

6.2 To pay the seller's necessary expenses

The buyer must reimburse the seller for expenses necessary to take care of the thing sold until delivery. Where land is sold, the purchaser must pay the transfer duty on the value of the land and any fixtures upon it.

6.3 To accept delivery of the thing being sold

The buyer must not do anything to prevent or delay delivery of the thing being sold, and must accept the delivery when it occurs.

7 Special sales

7.1 Sales by auction

At an auction without reserve, putting the thing up for sale is an offer, and each bid is an acceptance on the condition that there is no higher bid.

At an auction with reserve, putting the thing up for sale is an invitation to do business. Each bid is an offer that lapses when a higher offer is received. The offer may or may not be accepted by the auctioneer, who acts on behalf of the seller.[38]

7.2 Cost Insurance and Freight (CIF) sales

Where goods are transported by sea, ownership passes symbolically when the ‘bill of lading’ is delivered to the purchaser. The seller is entitled to payment as soon as the documents are provided to the buyer, even if the goods are damaged. Risk passes as soon as the contract is complete, but the buyer is protected by the insurance policy that the seller must take out.[39] The contract is performed when the shipping documents are delivered to the buyer.[40]

7.3 Free on Board (FOB) contracts of sale

The seller delivers the goods at his or her own expense. Once on board, the risk passes to the buyer. The buyer pays any insurance premiums and freight.

7.4 Free on Rail (FOR) contracts of sale

The seller at his or her own cost must place the goods onto railway carriages for delivery to the buyer. The seller then becomes entitled to payment. The buyer must pay the costs of railage.[41]

7.5 Sale in execution

The sheriff conducts a public auction of goods attached and removed from a debtor in terms of a court judgment. Aedilition remedies (dealt with later in this chapter) are not available to a buyer. Once the auction is over, the purchaser becomes the owner of the goods even if they never belonged to the debtor.[42]

7.6 Lay-by agreement

In terms of a lay-by agreement the consumer pays instalments while the supplier holds the goods until the full price is paid. Until then all the payments remain owned by the consumer, while the goods remain at the risk of the supplier.

For transactions covered by the Consumer Protection Act,[43] once the price is paid in full and if the supplier is not able to deliver the goods, the supplier must either deliver goods that are comparable, or refund the consumer double the money paid as a form of compensation. However, if the inability to deliver the goods was outside the control of the supplier, compensation is limited to a refund of the money paid plus interest. The failure will not be outside the supplier's control if it is because of his or her failure to carry out a routine matter relating to the business.

The supplier may charge a termination fee if the consumer cancels the lay-by before full payment. However, no termination fee may be charged if the reason for the cancellation was the death or hospitalisation of the consumer.

8 Ownership

8.1 Rights of the true owner

In a contract of sale, the buyer merely purchases the right of possession plus an implied warranty against eviction.[44]

‘Vindication’ is the right of the true owner to recover possession from anyone in whose possession the property is found. The ‘true owner's action’ is an action founded in Roman law.

8.2 Passing of ownership

The real right of ownership is different from the real right of possession and may pass at a different time from when possession passes.

For a court to find that ownership passed in a contract of sale, three elements must be proved:

- The seller must have been the owner at the time of delivery.
- The seller must have intended to pass ownership to the buyer on delivery.[45]
- The buyer must have intended to acquire ownership at the time of delivery.[46]

Ownership of movable property is transferred differently from the transfer of ownership of immovable property.[47]

8.2.1 Immovable property

The real right of ownership of immoveable property is transferred only on registration against the title deeds by the Registrar of Deeds. The registration process is the equivalent of delivery. Ownership is passed, even if the price has not yet been paid.

8.2.2 Incorporeal property

The real right of ownership of incorporeal property is transferred by cession. For example, the transfer of a patent will take place once agreement is reached in terms of a contract of cession.[48]

8.2.3 Movable property

The real right of ownership of moveable property can be transferred by actual delivery or constructive delivery.

Where movables are sold for cash, ownership does not pass until the price has been paid, even if there has been delivery. The agreed price must be paid and delivery effected before the article may be regarded as sold.[49]

There is a rebuttable presumption that every sale is a cash sale. If the seller agrees to accept payment on a day after the date of delivery, the seller will be deemed to have given credit.[50]

International Harvester (SA) (Pty) Ltd v AA Cook and Associates (Pty) Ltd [51]

The seller and the buyer agreed that a truck would be handed over to the buyer on delivery of a cheque. The buyer sent the cheque to his financial adviser, who told the seller it could be fetched the next morning. The seller released the vehicle. The cheque was dishonoured at the bank and the seller sued for the return of the truck.

The court held that the seller had agreed to provide credit and that ownership of the vehicle had passed to the buyer immediately on delivery. Accordingly the seller could not sue for the return of the truck.

The court may look at the facts to determine whether or not the sale was for cash or credit. Did the buyer want credit at the time of contract? Did he or she want credit subsequently?[52] Was security required? Were there previous dealings between the parties? Did the seller know that the goods were to be resold immediately?[53]

A current cheque indicates a cash sale, subject to the suspensive condition that it will be ‘met’. In other words, it will be a cash sale if the money is paid by the bank. The passing of ownership is postponed until payment is met, after which ownership is transferred retrospectively.[54] A post-dated cheque indicates a credit sale. Where movables are sold on credit, ownership passes immediately on delivery unless there is a clause in the contract delaying the transfer of ownership until after payment has been received.[55]

Concor Holdings (Pty) Ltd t/a Concor Technicrete v Potgieter [56]

A builder purchased paving stones from Concor on credit. The contract of sale provided that Concor would retain ownership until the paving stones were paid for. On failure to pay, Concor would be entitled to repossess the paving stones.

The builder laid the paving stones at premises belonging to Potgieter who paid the builder for them. However, the builder did not pay Concor. Concor brought the true owner's action against Potgieter for the return of the paving stones. Potgieter claimed that Concor had allowed the builder to remove the paving stones from Concor's premises and to cut the paving to fit the layout. Concor had thus made a representation to outsiders that the builder was the owner of the paving stones.

The court held that the test in regard to a representation made by conduct was whether the representor (Concor) should reasonably have expected that the representee (Potgieter) might be misled by its conduct, and if Potgieter acted reasonably in construing the representation the way he did. Concor had known that the paving stones were going to form part of the permanent work being constructed for Potgieter. The conduct of Concor could therefore reasonably have been expected to mislead Potgieter into believing that the builder had the right to transfer ownership in the paving stones, and Potgieter had acted reasonably in forming the belief which he did.

The court held in favour of Potgieter, and found Concor negligent since it must have been aware of the possibility that the builder might not pay the amount owing to it.

9 Warranties

A warranty is a representation of fact made by one party that is intended to be a term of the contract. Warranties may be express or implied.

9.1 Common-law warranties

Under the common law, the following two types of warranties are always implied in a contract of sale.

9.1.1 Implied warranty against eviction

The ‘right of possession’ is a term implied by law in a contract of sale. In terms of this right the seller warrants that the possession of the buyer will not be interfered with or disturbed by the seller or any third party as a result of any defect in the seller's title.

It is therefore possible for a seller to sell a thing of which he or she is not the true owner and without the owner's authority! Where the seller is fraudulent and knows he or she is not the owner, but represents that the thing is his or hers, the contract may be set aside by the aggrieved party.[57] Where the seller acts in good faith and there has been no misrepresentation, the contract is valid.

The buyer is protected, in terms of the implied warranty against eviction, if he or she suffers interference with his or her right of possession.[58] There are three ways in which the buyer is protected:

- The seller has a duty to come to the buyer's defence when the buyer's possession is threatened.
- The buyer must give the seller notice of the threat and put up a proper and competent defence. Otherwise, he or she may lose a right of recourse against the seller.[59]

> ***Lammers and Lammers v Giovannoni*** [60]
>
> The credit receiver of a car sold it to another person who stripped it, and sold the chassis to yet another person. The credit grantor, still the owner, succeeded in

regaining possession of the car. The dispossessed buyer called on the seller to assist him in defending his claim, but the seller did not do so.

The court held that once the seller had failed to come to the assistance of the buyer, the seller was not able to claim that the buyer should have been more vigorous in the buyer's defence of possession.

- If the buyer surrenders possession to a third party without letting the seller know, the seller will be liable only if the buyer can prove the incontestable title of the person to whom the property has been surrendered.

The warranty against eviction will not be implied in any of the following situations:

- The parties expressly agree the seller will not be liable in the event of the buyer's eviction. The seller must act in good faith or the sale will be voidable at the instance of the buyer for fraudulent non-disclosure. When the court is faced with fraudulent disclosure, it will not enforce a clause by which the goods are sold *voetstoots* or ‘as is’.
- The buyer was aware that a third party is the owner of the thing being sold.
- The cause of possession being lost occurs after the sale, and the seller was not at fault. For example, if there were a motor vehicle collision caused by a third party.

It is in some cases possible for liability for a breach of the warranty against eviction to be excluded by a clause in an agreement between the parties. However, these clauses cannot exclude the right of a disposed buyer from claiming a return of the purchase price.[61]

9.1.2 Implied warranty against latent defects

A ‘latent defect’ is a fault with the thing being sold that is not apparent to an ordinary person, even if it would be apparent to an expert. The defect must impair the usefulness or effectiveness of the thing for the purposes sold. A ‘patent defect’ is one that is easily discernible by an ordinary buyer at the time of delivery.[62]

The seller has a duty to deliver the thing being sold free from defects that make it unfit for the purpose for which it was sold. When goods are

ordered for a purpose known to the seller, it is implied that they will serve that purpose.[63]

Sarembock v Medical Leasing Services (Pty) Ltd and another [64]

The buyer of a sports car found out after the purchase that the front portion of the vehicle had been replaced, and claimed a reduction of the purchase price because his investment in the vehicle was substantially affected.

The court held that the car had been bought as an investment. Since the replaced portion reduced the value considerably it was therefore a latent defect.

The remedy for latent defect is the same as for breach of contract: the buyer may accept or reject the article. The buyer may waive his or her remedies by accepting the defective thing being sold.[65]

Goldblatt v Sweeney [66]

The buyer of a second-hand motor vehicle discovered that the vehicle had a latent defect, and sent it to the garage to repair the defect as well as several other repairs.

The court held he had accepted the latent defect.

In a contract of sale, the seller implicitly warrants that the article is not unfit for ordinary use or for a special use of which the seller was aware.

If the thing being sold is totally unfit for the proposed use, then the buyer may use the ‘redhibitorian action’, discussed below. The buyer cancels the contract, offers the return of the thing, reclaims the price with interest, and claims reimbursement of all expenses necessarily incurred in preserving the thing, as well as all carriage expenses. There is no claim for damages, that is, no monetary award of compensation.[67]

If the value of the thing being sold is reduced, the buyer may use the action to reduce the purchase price, discussed below. The buyer keeps the thing and claims a reduction in the price by the amount of the difference between the price and the true value. The buyer must prove that the goods were worth less than the price he or she paid for them. There is no claim for damages.[68]

The test for defect is an objective one, that is, the defect must impair the usefulness of the thing being sold for anyone, not just that particular buyer. The defect must ‘attach’ to the thing sold.[69]

Where the seller is a person who publicly professes skill or expert knowledge, or is an expert dealer, the buyer, in addition to the above remedies for latent defects, is entitled to claim consequential damages.[70]

D and H Piping Systems (Pty) Ltd v Trans Hex Group Ltd and another [71]

A pipe manufacturer had been buying gravel and sand from another company for over 30 years. One batch was latently defective and resulted in the failure of the concrete pipes it manufactured, causing liability of more than R13 million to its customers.

The seller argued that its standard terms and conditions on the back of the delivery notes and invoices it sent expressly excluded liability for consequential loss. The court held that these standard terms and conditions were not incorporated in the contract of sale between the parties. The seller had not made reasonably sufficient efforts to give the buyer notice of its standard terms, since it had only attached the terms to its invoices and delivery notes. By simply attaching these terms to invoices it was unlikely that they could reach someone authorised to accept them on behalf of the buyer.

The court held that a manufacturer is liable for consequential loss caused by a latent defect in the goods sold, even if it is ignorant of the latent defect. It will have such liability irrespective of whether it is skilled in the manufacture of such goods and irrespective of whether it publicly professes skill or expertise in that regard.

The seller will not be responsible for latent defects in any of the following situations:

- **The seller expressly contracts out of liability**: An agreement in which the thing is sold subject to a *voetstoots* or ‘as is’ clause expressly excludes the seller from liability for any latent defect. However, it will not protect the seller where the seller is fraudulent, that is, where he or she knows that knowledge of the defect would cause the buyer either not to buy at all or to insist on a lower price.

  Van der Merwe v Culhane[72]

  A property was sold *voetstoots* despite it being infested with wood-borer.

  The court held that the non-disclosure of this defect amounted to fraud, and despite the *voetstoots* clause the buyer was entitled to damages.

- **The defect does not exist at the time of sale**: Here the risk passes in the normal way. For the risk to revert to the seller, the buyer must prove that the defect existed at the time of the sale. If the defect is discovered shortly after the sale, there is an inference of ‘retrospective continuity’, that is, that the defect existed at the time of sale.

- **The buyer was aware of the defect at the time of sale, or subsequently became aware and accepted the position, explicitly or implicitly**: Here the buyer waives his or her rights against the seller. The buyer must reject the article within a reasonable time or lose the remedy against latent defects. The buyer implicitly accepts the condition of the thing if he or she continues to use the article, exercises an act of ownership, or pays the price after discovery of the latent defect.[73]

> ***Schwarzer v John Roderick's Motors (Pty) Ltd*** [74]
>
> The buyer of a second-hand motor vehicle found a defect in the oil pump two weeks after the sale. She had it repaired at the garage and continued to use the car and to pay instalments on it.
>
> The court held she was not entitled to cancel the contract.

- **Prescription has intervened**: This means that more than three years have passed since the cause of action arose.

9.2 Statutory warranties and protections

A clause excluding liability for eviction is invalid in a credit agreement under the Credit Agreements Act.[75]

Under the Consumer Protection Act,[76] four warranties are provided in transactions to which the Act applies. The parties are therefore limited to their common-law rights if the Act does not apply to their particular transaction. Refer to chapter 30 in this text on consumer protection for details on which transactions are covered by the Act, and which are not covered.

9.2.1 Consumer's right to assume supplier is entitled to sell goods

There is an implied warranty against eviction in every transaction covered by the Act. The consumer is entitled to assume that the supplier has the legal right or the authority of the owner to sell the goods, and that no true owner will dispossess him or her of the goods. If this happens then the supplier will be liable for all the true owner's damages that were not disclosed to the consumer in writing before the sale was concluded.

9.2.2 Consumer's right to fair value, good quality and safety

Generally, if the Act applies to the particular transaction, the buyer has a right to receive goods that are reasonably suitable for the purposes for which they are generally intended; are of good quality, in good working order and free of any defects; will be useable and durable for a reasonable period of time; and comply with any applicable standards set under the Standards Act.[77] However, this does not apply if the goods were offered in a specific condition that was expressly accepted by the buyer. For example, goods sold *voetstoots*.

If the buyer specifically informed the seller of the purpose of the goods, and the seller ordinarily offers to supply the goods or acts in a way that is consistent with being knowledgeable about the use of the goods, then the buyer has a right to expect that the goods are reasonably suitable for that specific use.

In deciding if the goods are reasonably suitable, it does not matter whether the product failure was latent or patent, or if it could have been detected by the buyer before accepting the goods.

9.2.3 Consumer's warranty of quality

The Consumer Protection Act[78] provides for an implied warranty of quality in applicable transactions for the supply of goods and services (excluding goods bought at auction).

Within six months after the delivery of any goods, the buyer may return the goods to the seller without penalty and at the seller's risk and expense, if the goods are not reasonably suitable. The buyer may require the seller to either repair or replace the goods; or refund the price paid. If the seller repairs the goods, and within three months the goods are still not reasonably suitable, the seller must replace the goods or refund the price.

9.2.4 Consumer's warranty on repaired goods

In respect of transactions covered under the Consumer Protection Act,[79] a seller of services warrants every new or reconditioned part installed during any repair or maintenance work for three months or for such longer period

as the seller may specify in writing. The warranty is void if the buyer abuses the goods, or if the repair fails due to ordinary wear and tear.

10 Remedies available to the buyer

10.1 Common-law remedies

10.1.1 Aedilitian remedies

The aedilitian remedies are available to the buyer where there is a breach of an implied warranty against latent defects, as discussed above, or when a false ‘material statement of praise’ was made of the thing.[80] A false material statement of praise is also known as a false *dictum et promissum*.

- **Redhibitorian action**: This is also known as the *actio redhibitoria*. This remedy is available only if the latent defect is material and would render the goods defective for anyone, not just for the particular buyer. The buyer may sue to return the parties to their respective positions prior to the contract. The buyer recovers the price and must return the thing to the seller. The buyer also may claim interest and compensation for expenses involved in maintaining the thing. No damages for any additional losses may be claimed.
- **Action for reduction of the purchase price**: This is also known as the *actio quanti minoris*. The buyer sues for a reduction in the purchase price, to the true value of the damaged thing being sold in the condition at delivery, that is, the difference between the price paid and the value. The buyer must tender the return of the thing. No damages may be claimed.[81]

A false ‘material statement of praise’ or *dictum et promissum* means a false statement made by the seller during negotiations before the contract is entered into. The statement must bear on the quality or value of the thing sold and go beyond mere praise or commendation. It must be reasonably interpreted that the statement was intended to be acted upon by the buyer.

Whether the statement goes beyond mere praise or commendation will depend on answers to the following questions:

- Was the statement made in answer to the buyer's question?

- Was the statement material to a known purpose for which the buyer was buying?
- Was the statement one of fact or personal opinion?
- Was it obvious that the seller was merely praising his or her goods?[82]

Phame (Pty) Ltd v Paizes [83]

The agent for the seller of a shopping centre told the buyer that the municipal rates were about a third of what they really were.

The buyer successfully claimed a reduction in the purchase price.

10.1.2 Action for consequential damages[84]

In addition to the aedilitian remedies, the buyer may in certain situations claim consequential damages, using an action known as the *actio ex empti*. These situations include the following:

- **The seller is fraudulent**: The buyer must show that the seller knew of the latent defect and deliberately kept quiet about it. The court will presume, where the seller kept quiet about a defect, that the seller was deliberately fraudulent.[85]
- **The seller is a manufacturer of the goods, or an expert, or publicly professes to have expert skill or knowledge**: An expert is someone who publicly professes to have attributes of skill and expert knowledge in relation to goods sold.[86]

Innocent and negligent dealers are protected by *voetstoots* clauses. If the dealer sells the goods *voetstoots*, the non-communication of the defect will not be sufficient to give the buyer a claim for damages, unless the seller was aware of the defect.

Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd [87]

Certain walls had to be demolished after defective bricks were sold by the manufacturer.

The court held that the manufacturer was liable for the costs of demolishing the walls, as well as the costs of rebuilding them.

Minister van Landbou-tegniese Dienste v Scholtz [88]

> A farmer bought a stud bull from a breeder of such animals. It appeared that the bull was not fit for breeding purposes, and the farmer successfully sued for consequential damages using the *actio ex empti*.

In the case of a manufacturer who does not sell the defective product directly to the injured party, there is no contract between the manufacturer and injured party. Under the common law, liability, if any, can arise only in terms of the law of delict. Anyone claiming delictual damages for product liability must prove fault in the form of intention or negligence on the other person's part. If, however, the transaction is covered by the Consumer Protection Act,[89] then the situation is now changed, and the manufacturer may be liable under the Act. If the transaction is not covered by the Act, then the common-law remedies will apply, and liability can only arise through the law of delict. Refer to web-based chapter 37 on delict for details of aquilian liability.

- **The seller has given an express warranty against the existence of the defect**: The ordinary remedies available for breach of the terms of a contract apply to breach of an express warranty. The particular remedies available depend on how material the term is.[90]

10.2 Statutory remedies under the Consumer Protection Act[91]

10.2.1 Producers, importers, distributors and retailers

If the sale is a transaction covered by the Consumer Protection Act,[92] then producers, importers, distributors and retailers have a strict form of liability that does not require fault. All these people can now be held jointly and severally liable by consumers. This means the consumer has the choice to sue them all together, or may choose any one of them to sue.

The Act does allow for some defences. Liability will not arise if:

- The harm was caused entirely because of compliance with a public regulation.

- The defect or hazard did not exist at the time the product was supplied to any person in the chain of people from whom the goods were received.
- The defect or hazard arose entirely because of instructions given by someone in the chain of people from whom the goods were received.
- It is unreasonable to expect a distributor or retailer to have discovered the defect or hazard.
- If a claim is launched more than three years from the time a consumer first knew of the material facts giving rise to the harm.

Refer to chapter 30 in this text on consumer protection for details of the transaction to which the Act applies, and to which the Act does not apply.

10.2.2 Consumer's right to return goods

If a transaction is covered under the Consumer Protection Act,[93] then a buyer has the right to return unsafe or defective goods to the seller. This must be done within ten business days of delivery. The seller must then refund the price paid. A reasonable fee may be charged only if the goods have been used or need repackaging.

If the goods were sold through direct marketing and the buyer has cancelled the agreement during the cooling-off period, then the goods must be returned at the expense and at the risk of the buyer. If the buyer has rejected delivery, or if the goods were found within ten business days after delivery to be unsuitable for the purposes they were sold, the goods must be returned at the expense and at the risk of the seller.

Goods that have combined with or been attached to other property do not have to be returned.

11 Remedies available to the seller

Where the buyer is in default by not paying the price on the due date, the seller may sue for payment, or cancel the contract if ‘time is of the essence’ of the contract. The seller may make time of the essence by demanding payment and simultaneously giving notice of rescission. Notice of rescission means notice that, in the event of non-payment by a reasonable date under the circumstances, the seller will cancel the contract.

Where the buyer fails to pay at all, the seller may cancel the contract only if it can be reasonably inferred from the buyer's conduct that the buyer has no intention of paying in future.

Where the buyer is in default by refusing to accept delivery, the seller has a choice of either specific performance or cancellation, and, in addition a claim for damages:

- **Specific performance**: The buyer can be compelled by the court to accept delivery of the thing being sold.
- **Cancellation**: The seller may not cancel unless failure to accept delivery amounts to total repudiation. The seller may make time of the essence by giving notice of rescission in the same manner as for non-payment of the price.
- **Damages**: In the case of both the above two remedies, the seller also has an action to recover money spent in maintaining or preserving the thing being sold.

Attorneys who draw up written agreements of sale often insert a cancellation clause into such agreements. This clause is written into the contract at the time of sale, and is an express agreement between the buyer and the seller that on non-payment of the price by the due date, the seller will have the choice to treat the contract as cancelled.

PRACTICALLY

SPEAKING

Things to include in a contract to buy or sell a business

- **Definitions and interpretation**: Definitions are very important in contracts of sale. For example, ‘stock’ may be defined as stock, inventory, raw materials, goods and other assets purchased for resale, component parts, partly finished and finished goods, packaging and promotional materials, and work in progress.
- **Vendor's debts**: Will these be deducted from the purchase price or is the price inclusive of these?
- **Payment of deposit and balance of purchase price**: How much will be paid as a deposit, and what terms will apply to the balance? Will the balance be funded from future business profits, and if so, what security will be held to ensure payment if the buyer defaults? What insurance will be taken out to pay the balance if the buyer dies or the business is destroyed, for example through fire?
- **Stock valuation**: How much will the stock be worth, and how will it be depreciated?
- **Running the business before it is handed over**: Sometimes getting the necessary finances and other approvals can take many months. How will the business be run before it is finally handed over to the buyer, and who decides on risky issues? Does the seller have the right to enter into long-term contracts that will be binding on the new owner?
- **Restraints of trade**: Sometimes the seller has unique knowledge. The new buyer may wish to prevent the former owner from opening in competition. Sometimes the buyer may pay an additional amount called ‘goodwill’ to take over the good name and reputation of the business.
- **Employees**: How will employment contracts be recognised by the new owner?
- **Contracts and leases**: The buyer will have to step into the shoes of the former owner, and all contracts will continue.

THIS CHAPTER IN ESSENCE

1 A sale is a contract in which a seller promises to deliver a thing to a buyer who agrees to pay a certain price.
2 Legally, an agreement to sell something does not mean that ownership of the thing being sold is transferred from the seller to the buyer.
3 The real right of ownership is different from the real right of possession and may pass at a different time from when possession passes. Ownership of movable property is transferred differently from the transfer of ownership of immovable property.
4 Duties of the seller are to take care of the thing being sold until it is delivered; and to deliver the thing being sold to the buyer. Delivery may be actual or constructive.
5 Duties of the buyer are to pay the purchase price; to pay the seller's necessary expenses; and to accept delivery of the thing being sold.
6 The risk passes to the buyer as soon as the contract is ‘complete’ or *perfecta*. Risk can pass at a different time to when ownership passes. There are several situations in which risk does not pass immediately.
7 The Consumer Protection Act creates implied conditions in every transaction to which it applies.
8 A warranty is a representation of fact made by one party that is intended to be a term of the contract. Warranties may be express or implied.
9 Under the common law, the following two types of warranties are always implied in a contract of sale: the implied warranty against eviction; and the implied warranty against latent defects. Under the Consumer Protection Act, four warranties are provided in transactions to which the Act applies: The consumer's right to assume the supplier is entitled to sell goods; consumer's right to fair value, good quality and safety; consumer's warranty of quality; and the consumer's warranty on repaired goods.

10 The aedilitian remedies are available to the buyer where there is a breach of an implied warranty against latent defects, or when a false ‘material statement of praise’ or a false *dictum et promissum* was made.
11 In some cases an action is available for consequential damages. Additional statutory remedies may also be available under the Consumer Protection Act.

QUESTIONS

Short questions (1–5 marks)

1. Define sale.
2. List two duties of a seller.
3. List five instances where risk does not pass immediately to the buyer.
4. What are the two warranties that are always implied by the common law in a contract of sale?
5. List three requirements for ownership to pass.
6. What are the two remedies available to a buyer where the thing being sold is defective?
7. List three duties of the buyer in a contract of sale.
8. State three forms of delivery in respect of moveable and immoveable property.

Paragraph questions (5 marks)

1. Discuss the two remedies that are available to the buyer where the thing being sold is defective.
2. Discuss the remedies available to a buyer and a seller when the other is in default.
3. Discuss the liability of the seller for latent defects in the object sold by him or her to a purchaser, with specific reference to *voetstoots* sales.
4. Fully discuss the special liability of the expert dealer for latent defects in a contract of sale.

Essay questions (10 marks)

1. What is meant by delivery? In your answer, outline various forms of delivery.
2. Discuss the effect of the Consumer Protection Act on the law of sale.
3. Discuss the concept of risk in a contract of sale and the factors relevant to the passing of the risk.
4. Discuss the passing of ownership in a contract of sale.

Problem questions (20 marks)

1. On Monday, Sarah sells her motor vehicle to Benny for R5 000. They agree that Benny will pay Sarah immediately, but that Sarah will only deliver the vehicle to Benny on Thursday. On Wednesday, lightning destroys the vehicle while parked outside Sarah's house. Discuss the legal position of each. Would your answer be any different if Sarah had failed to deliver the car on Thursday, and the car had been struck by lightning outside her house on Saturday?
2. Louis advertises second-hand clothing for sale at a low price, on the condition that it is sold *voetstoots*. Mark, a market trader, examines some items and finds them to be in a reasonable condition. He orders 800 ties for resale, a shirt for himself, and underwear for his daughter. The ties are so badly torn that none can be resold; the shirt is badly stained; and the underwear causes a skin infection. Advise Mark.
3. Vusi purchases various imported delicacies from a supermarket for R250. Unknown to both Vusi and the supermarket, the delicacies are off and Vusi contracts food poisoning when he consumes them. This causes him a great deal of pain and suffering, as well as considerable medical expenses. Is the supermarket potentially liable?
4. Sipho, who deals exclusively in imported foodstuffs, sells a tin of New Zealand meat to Bert. Bert becomes violently ill because the meat is off. Bert is hospitalised for a week, and has to pay a hospital bill of R25 000. Sipho says that he could not have known that the meat was bad, as it was in a sealed tin and, at most, he would be willing to refund Bert the price of the tin of meat, which was R10. Discuss fully.

5. Harold is a squatter who is desperately poor. He meets a strange man in a bar who offers him R20 000 to buy one of his kidneys for transplant. Harold agrees, but later gets worried. Advise Harold of his rights.

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1 Fouché, 135; Gibson, 116; Havenga et al., 123; Sharrock, 232; Swanepoel et al., 81.

2 Gibson, 116; Swanepoel et al., 90–96.

3 Alienation of Land Act 68 of 1981.

4 *Just Names Properties 11 CC and another v Fourie and others* 2007 (3) SA 1 (W).

5 Credit Agreements Act 75 of 1980.

6 Insolvency Act 24 of 1936.

7 Fouché, 136; Gibson, 119; Havenga et al., 123–124; Swanepoel et al., 83.

8 Swanepoel et al., 83–86.

9 *Frye's (Pty) Ltd v Ries* 1957 (3) SA 575 (A).

10 *Kleynhans Bros v Wessels' Trustee* 1927 AD 271.

11 Fouché, 136–136; Gibson, 120–121; Havenga et al., 124; Swanepoel et al., 86–89.

12 *Mountbatten Investments (Pty) Ltd v Mohammed* 1989 (1) SA 172 (D).

13 *R v Pearson* 1942 EDL 117.

14 Consumer Protection Act 68 of 2008.

15 Fouché, 143–144; Gibson, 122–125; Havenga et al., 125, 130–131; Sharrock, 238–240; Swanepoel et al., 91.

16 Sharrock, 240.

17 *Schultz v Morton and Company* 1918 TPD 343.

18 *Equistock Group CC t/a Autocity Motor Holdings v Mentz* [2004] 2 All SA 46 (T).

19 *De Wet v Zeeman* 1989 (2) SA 433 (NC); Sharrock, 239.

20 *Quirk's Trustees v Assignees of Liddle and Co* (1885) 3 SC 32; *Schultz v Morton and Company* 1918 TPD 343.

21 *Poppe Schunhoff and Guttery v Mosenthal and Company* 1879 Buch 91; *Taylor and Company v Mackie Dunn and Company* 1879 Buch 166; *Horne v Hutt* 1915 CPD 331.

22 *Poppe Schunhoff and Guttery v Mosenthal and Company* 1879 Buch 91.

23 Consumer Protection Act 68 of 2008.

24 Fouché, 139–141; Gibson, 118–119; Havenga et al., 125, 129; Swanepoel et al., 91–95.

25 Sharrock, 241.

26 *Gilson v Payn* (1899) 16 SC 286; *Stephen Fraser and Company v Clydesdale Transvaal Collieries Ltd* 1903 TH 121.

27 *Groenewald v Van der Merwe* 1917 AD 233; *Xapa v Ntsoko* 1919 EDL 177.

28 *Xapa v Ntsoko* 1919 EDL 177.

29 *Southern Tankers (Pty) Ltd t/a Unilog v Pescana D'Oro Ltd (Velmar Ltd Intervening)* 2003 (4) SA 566 (C).

30 Consumer Protection Act 68 of 2008.

31 Fouché, 138–140; Gibson, 152–153; Havenga et al., 124–128; Sharrock, 251–253; Swanepoel et al., 101–102.

32 South African Reserve Bank Act 90 of 1989.

33 *Schneider and London v Chapman* 1917 TPD 497.

34 *Mannesmann Demag (Pty) Ltd v Romatex and another* 1988 (4) SA 383 (D).

35 Sharrock, 195.

36 Ibid.

37 Ibid.

38 Fouché, 145; Gibson, 162–163.

39 *Lendalease Finance (Pty) Ltd v Corporation de Mercadeo Agricola* 1976 (4) SA 404 (A).

40 *Garavelli and Figli v Gollach and Gomperts (Pty) Ltd* 1959 (1) SA 816 (W); Fouché, 133; Gibson, 160–162; Sharrock, 256–257; Swanepoel et al., 108.

41 Gibson, 162; Sharrock, 238; Swanepoel et al., 108–109.

42 Sharrock, 236–237.

43 Consumer Protection Act 68 of 2008.

44 Fouché, 137; Gibson, 82–83; Havenga et al., 128–130.

45 *Weeks v Amalgamated Agencies Ltd* 1920 AD 218.

46 *Greenshields v Chisholm* (1884) 3 SC 220.

47 Sharrock, 237–238.

48 Sharrock, 237.

49 *Laing v South African Milling Co Ltd* 1921 AD 387.

50 *International Harvester (SA) (Pty) Ltd v AA Cook and Associates (Pty) Ltd* 1973 (4) SA 47 (W).

51 Ibid.

52 *Sadie v Standard Bank* (1889) 7 SC 87; *Grosvenor Motors (Potchefstroom) Ltd v Douglas* 1956 (3) SA 420 (A).

53 *Eriksen Motors (Welkom) Ltd v Protea Motors* 1973 (3) SA 685 (A).

54 *Bold v Cooper* 1949 (1) SA 1195 (W); *Grosvenor Motors (Potchefstroom) Ltd v Douglas* 1956 (3) SA 420 (A).

55 *Daniels v Cooper* (1880) 1 EDC 174.

56 *Concor Holdings (Pty) Ltd t/a Concor Technicrete v Potgieter* [2004] 4 All SA 589 (SCA).

57 *Kleynhans Bros v Wessels' Trustee* 1927 AD 271.

58 *Alpha Trust (Edms) Bpk v Van der Watt* 1975 (3) SA 734 (A); Fouché, 139; Gibson, 140–142; Havenga et al., 126; Sharrock, 242–245; Swanepoel et al., 96–97.

59 *Lammers and Lammers v Giovannoni* 1955 (3) SA 385 (A).

60 Ibid.

61 *Vrystaat Motors v Henry Blignaut (Edms) Bpk* 1996 (2) SA 448 (A).

62 *Lakier v Hager* 1958 (4) SA 180 (T); Fouché, 140–141; Gibson, 135–139; Havenga et al., 126–128; Sharrock, 246–251; Swanepoel et al., 97–101.

63 *Goldblatt v Sweeney* 1918 CPD 320; *Kroomer v Hess and Company* 1919 AD 204.

64 *Sarembock v Medical Leasing Services (Pty) Ltd and another* 1991 (1) 334 (A).

65 *Goldblatt v Sweeney* 1918 CPD 320.

66 Ibid.

67 *Hall and Company v Kearns* (1893) 10 SC 152; *Kroomer v Hess and Company* 1919 AD 204.

68 *Mostert v Noach* (1884) 3 SC 174.

69 *Dibley v Furter* 1951 (4) SA 73 (C).

70 *Young's Provision Stores (Pty) Ltd v Van Ryneveld* 1936 CPD 87; *Kroonstad Westelike Boere Ko-operatiewe Vereeniging Bpk v Botha* 1964 (3) SA 561 (A); *Consol Ltd t/a Consol Glass v Twee Jonge Gezellen (Pty) Ltd and another* 2005 (6) SA 1 (SCA).

71 *D and H Piping Systems (Pty) Ltd v Trans Hex Group Ltd and another* 2006 (3) SA 593 (SCA).

72 *Van der Merwe v Culhane* 1952 (3) SA 42 (T).

73 *Schwarzer v John Roderick's Motors (Pty) Ltd* 1940 OPD 170.

74 Ibid.

75 Credit Agreements Act 75 of 1980.

76 Consumer Protection Act 68 of 2008.

77 Standards Act 29 of 1993.

78 Consumer Protection Act 68 of 2008.

79 Ibid.

80 Fouché, 141–143; Gibson, 139–140, 142–146; Havenga et al., 127–128; Swanepoel et al.,103–104.

81 *SA Oil and Fat Industries Ltd v Park Rynie Whaling Co Ltd* 1916 AD 40.

82 *Phame (Pty) Ltd v Paizes* 1973 (3) SA 397 (A).

83 Ibid.

84 Fouché, 129–130; Gibson, 135; Sharrock, 249–250; Swanepoel et al., 102–103.

85 *Young's Provision Stores (Pty) Ltd v Van Ryneveld* 1936 CPD 87; *Glaston House (Pty) Ltd v Inag (Pty) Ltd* 1977 (2) SA 846 (A).

86 *Young's Provision Stores (Pty) Ltd v Van Ryneveld* 1936 CPD 87; *Kroonstad Westelike Boere Ko-operatiewe Vereeniging Bpk v Botha* 1964 (3) SA 561 (A); *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 (3) SA 670 (A); *Langeberg Voedsel Bpk v Sarculum Boerdery Bpk* 1996 (2) SA 565 (A); Pothier, *Traite' du Contrat de Vente* sec. 214.

87 *Holmdene Brickworks (Pty) Ltd v Roberts Construction Co Ltd* 1977 (3) SA 670 (A).

88 *Minister van Landbou-tegniese Dienste v Scholtz* 1971 (3) SA 188 (A).

89 Consumer Protection Act 68 of 2008.

90 *Evans and Plows v Willis and Company* 1923 CPD 496.

91 Consumer Protection Act 68 of 2008.

92 Ibid.

93 Ibid.

Chapter 17

Credit agreements

'Credit: A system whereby a person who can't pay gets another person who can't pay to guarantee that he can pay.'

CHARLES DICKENS (1812–1870)
ENGLISH AUTHOR AND SOCIAL REFORMER

What is covered in this chapter

1 Purposes of the National Credit Act
2 Application of the Act
3 Types of credit agreement
4 The National Credit Regulator
5 The National Consumer Tribunal
6 Regulation of the consumer credit industry
7 Consumer rights
8 Credit records
9 Credit marketing practices
10 Prevention of reckless credit
11 Application for debt review
12 Unlawful credit agreements
13 Unlawful provisions of credit agreements
14 Further protections for consumers and credit providers
15 Termination of a credit agreement
16 Debt enforcement by repossession or court judgment

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Not many people can afford to pay cash for expensive things like furniture or motor cars, and it is important to understand what protection the law gives to buyers and sellers who enter into credit agreements.

What protection do consumers have against unfair tactics being used by credit providers? As credit providers developed clever wording that made credit agreements more and more one-sided, it became necessary for legislation to protect consumer rights better. Consumer rights regarding credit agreements are protected under the National Credit Act;[1] extra protection may be provided under the Consumer Protection Act[2] for credit agreements that are classed as 'transactions'.

You should understand the legal processes that must take place when a consumer gets into trouble with payment of instalments under a credit agreement; how a debt review can be applied for, and how a credit agreement can be terminated legally.

1 Purposes of the National Credit Act[3]

The purposes of the Act are to promote a fair, competitive, and accessible credit market, and to protect consumers. It does this by prohibiting unfair credit and credit-marketing practices, and by promoting responsible credit granting and use. Information must be disclosed to consumers to enable them to make informed choices, and protect them from deception and unfair conduct by credit providers. The Act also provides for an accessible system to resolve disputes and for debt reorganisation in cases of over-indebtedness.

2 Application of the Act

The National Credit Act applies to every credit agreement in South Africa except for the following:

- A consumer that is a single juristic person, or a number of related juristic entities, with an asset value or annual turnover of more than R1 million.
- The consumer is the State.
- The agreement is a large credit agreement, such as a mortgage, or credit facility or credit transaction (excluding a pawn transaction) of more than R250 000.
- The credit provider is the South African Reserve Bank.
- The credit provider is located outside the Republic.

> ***Firstrand Bank Limited v Carl Beck Estates (Pty) Ltd and another*** [4]
>
> A bank sued a company for moneys lent and advanced, as well as an individual who signed a suretyship for the company's obligations.
>
> The court held that as a juristic person the company had entered into a large credit agreement. As a result the National Credit Act did not apply to the agreement, and therefore also did not apply to the suretyship.

The Act specifically does not apply to any of the following:

- A loan provided to a juristic person by someone with a controlling interest in that juristic person.
- A credit agreement between natural persons in a family who are dependent on each other.
- A policy of insurance.
- A lease of immovable property.
- A transaction between members of a *stokvel*, which consists of two or more persons in a voluntary association, each of whom has pledged support to the others. It raises funds by member subscriptions, and grants credit to and on behalf of members. Members share in profits and nominate management of the scheme, and rely on self-imposed regulation.

The Act further has sections that do not apply when the consumer is a juristic person.

3 Types of credit agreement

The National Credit Act creates three types of credit agreement:

- **Small credit agreement**: A pawn transaction, credit facility or credit transaction (excluding a mortgage) of less than R15 000.
- **Intermediate credit agreement**: A credit facility or credit transaction (excluding a pawn transaction or mortgage) of between R15 000 and R250 000.
- **Large credit agreement**: A mortgage agreement, or credit facility or credit transaction (excluding a pawn transaction) of more than R250 000.

4 The National Credit Regulator

The functions of the National Credit Regulator (NCR) are to develop an accessible credit market for historically disadvantaged persons and low-income earners.

It investigates alleged contraventions of the Act, and negotiates undertakings and consent orders. It may issue and enforce compliance notices to a person who does not comply with a provision of the Act. If a person fails to comply with a compliance notice without raising an objection, the NCR may refer the matter to the National Prosecuting Authority or to the National Consumer Tribunal for an appropriate order.

The NCR also maintains a register of credit providers, credit bureaux and debt counsellors.

5 The National Consumer Tribunal

The functions of the National Consumer Tribunal are to adjudicate any application that may be made to it in terms of the National Credit Act, and to determine whether prohibited conduct has occurred. If so, the Tribunal may impose a remedy, together with an order for costs.

Any person issued with a compliance notice from the National Credit Regulator may apply to the Tribunal to review the notice within 15 business days. The Tribunal may confirm, modify or cancel all or part of a notice. The applicant must comply with that notice as confirmed or modified, within the time period specified.

Any registration in terms of this Act may be cancelled by the Tribunal on request by the National Credit Regulator if the registrant repeatedly fails to comply with any condition of its registration; or fails to meet a commitment in terms of (i) black economic empowerment; (ii) combating over-indebtedness; or (iii) its subscription to any relevant industry code of conduct.

6 Regulation of the consumer credit industry

6.1 Registration as a credit provider

A person must register as a credit provider if they have provided credit in 100 or more credit agreements or the total debt owed to that person in terms of all their credit agreements is more than R500 000.

An unregistered person may not act as a credit provider, and any credit agreement entered into by such an unregistered person is void.

6.2 Registration of credit bureaux

A juristic person must apply to be registered as a credit bureau if it is in business to:

- Investigate credit applications, credit agreements, payment history or patterns, or consumer credit information of current or prospective consumers.
- Compile and maintain data from credit reports.
- Issue credit reports concerning consumers.

Registration will only be allowed if the National Credit Regulator believes the applicant has sufficient human, financial and operational resources to enable it to function efficiently; with procedures to deal equitably with concerns and complaints of consumers or credit providers; and is registered with the South African Revenue Services.

A juristic person may not be registered as a credit bureau if a person with a controlling interest in the applicant is a credit provider or a debt collection agency.

6.3 Registration of debt counsellors

Only natural persons over 18 years of age may apply to be registered as debt counsellors, subject to such conditions as the National Credit

Regulator may impose. No registered credit provider may be registered as a debt counsellor.

7 Consumer rights

7.1 The right to apply for credit

Every adult natural person, and every juristic person, has a right to apply to a credit provider for credit. A credit provider may refuse to enter into a credit agreement on reasonable commercial grounds consistent with its customary risk management and underwriting practices.

No credit provider, credit bureau, ombud or debt counsellor may unfairly discriminate against any person on any of the grounds set out in section 9(3) of the Constitution[5] or Chapter 2 of the Promotion of Equality and Prevention of Unfair Discrimination Act.[6] Unfair discrimination is prohibited when:

- Assessing the ability of the person to meet the obligations of a proposed credit agreement.
- Deciding whether to refuse an application to enter into a credit agreement, or to offer a credit agreement.
- Proposing or agreeing to the terms and conditions of a credit agreement, or determining any costs of a credit agreement to the consumer.
- Assessing or requiring compliance by the person with the terms of a credit agreement.
- Exercising any right of the credit provider under a credit agreement.
- Determining whether to continue, enforce, or terminate a credit agreement.
- Determining whether to report, or reporting, any credit information.

7.2 Right to reasons for credit being refused

On request from a consumer, a credit provider must provide a written reason for refusing to enter into a credit agreement, offering a lower credit limit than applied for, refusing a request to increase a credit limit, or for refusing to renew an expiring credit card. If the decision is based on an adverse credit report, the credit provider must advise the consumer in writing of the name, address and other contact particulars of that credit bureau.

If the credit provider fails without reasonable cause to respond to a request made for reasons for refusal of credit, the equality court may draw an inference that a credit provider has discriminated unfairly against a consumer.

7.3 Right to information in official language

A consumer has a right to receive a document in an official language that is read or understood by the consumer. However, this right must be reasonable having regard to usage, practicality, expense, regional circumstances and the balance of the needs and preferences of the population.

A registered person under the Act may apply to the National Credit Regulator to provide documents in either the same official language for use throughout South Africa, or at least two different official languages in regions, and offer each consumer the opportunity to choose.

7.4 Right to information in plain and understandable language

A document is in ‘plain language’ if an ordinary consumer who is part of the group of people for whom the document is intended, with average literacy skills and minimal credit experience, could be expected to understand the contents and significance of the document without too much effort.

7.5 Right to receive documents

If no method of delivery of documents has been agreed, then it must be made available to the consumer at the credit provider's business premises, or sent by ordinary mail, fax, e-mail or printable web page.

A credit provider must not charge a fee for the original copy of any document required to be delivered to a consumer in terms of the Act. On written request the credit provider must provide the consumer with a free single replacement copy of a document at any time within a year after the date for original delivery of that document. Additional replacement copies may be charged for.

7.6 Right to confidentiality

Any person who receives or keeps confidential information pertaining to a consumer or prospective consumer must protect the confidentiality of that information.

They may use that information only for a purpose permitted in terms of the Act. Information may only be reported or released to the consumer or to another person to the extent allowed by law.

8 Credit records

8.1 Information held by a credit bureau

A credit bureau may keep credit information about a consumer concerning:

- Credit history, including applications for credit, credit agreements, default, debt rearrangement, enforcement actions and the circumstances of termination of any credit agreement.
- Financial history, including the person's past and current income, assets and debts, and other matters within the scope of that person's financial means, prospects and obligations.
- Education and employment history, including the person's education, employment, career, professional or business history, including the circumstances of termination of any employment, career, and professional or business relationship.
- Identity, including the person's name, date of birth, identity number, marital status and family relationships, past and current addresses and other contact details.

A registered credit bureau must take reasonable steps to verify the accuracy of any consumer credit information reported to it. This includes filing information for free from a consumer to correct information concerning that consumer.

It must maintain its records of consumer credit information in accordance with the prescribed standards and promptly expunge any prescribed consumer credit information that is not permitted or that must be removed.

A report must be issued to any person who requires it for a prescribed purpose on payment of a fee, except where the Act states that no fee is to be charged. No negative inference about a person's creditworthiness may be drawn just because the credit bureau has no consumer credit information concerning that person.

A credit bureau must not knowingly or negligently provide a report to any person containing inaccurate information.

8.2 Removal of record of debt adjustment or judgment

A consumer whose debts have been rearranged in terms of the National Credit Act may apply to a debt counsellor for a clearance certificate. The debt counsellor must then investigate the circumstances of the debt rearrangement, and either issue or refuse to issue a clearance certificate. On refusal, the consumer may apply to the Tribunal to review that decision.

On receipt of a clearance certificate, a credit bureau, or the national credit register, must expunge from its records any information relating to any default by the consumer that may have lead to the debt rearrangement, and the fact that the consumer was subject to the relevant debt rearrangement order or agreement.

8.3 Right to access and challenge credit records

Every person has the right to be advised by a credit provider before any adverse information is reported to a credit bureau, and to receive a copy of that information on request. You may also inspect any credit bureau, or national credit register, file or information concerning yourself once every 12 months free of charge. You may inspect any of these at any other time for a fee.

Every person may challenge the accuracy of any information concerning themselves that is held by the credit bureau or national credit register, and may require the credit bureau or National Credit Regulator to investigate the accuracy of any challenged information, free of charge.

9 Credit marketing practices

A credit provider must not cause a consumer to enter into a credit agreement by notifying the consumer that there will be an automatic credit agreement unless the consumer expressly refuses the offer. Similarly, a credit provider must not cause a consumer to increase the credit limit under a credit facility, on the basis that the limit will automatically be increased unless the consumer specifically declines the offer. Any such provision is unlawful and void.

The credit provider must always give a consumer the opportunity to refuse annual credit limit increases if the agreement is a credit facility, and to be excluded from any telemarketing campaign, marketing or customer list, or any mass distribution of e-mail or SMS messages.

A credit provider must not enter into a credit agreement at a private dwelling except during a visit pre-arranged by the consumer for that purpose; or, if the credit provider was visiting to offer goods or services for sale, and incidentally offered to provide or arrange credit.

A credit provider must not visit a person's place of employment to induce the person to apply for or obtain credit, or enter into a credit agreement, unless this was arranged by the credit provider, and the employer and any representative trade union or employee; or the visit was a non-prompted invitation by the person being visited. An employer or representative trade union that enters into an arrangement with a credit provider must not receive any fee, commission, payment, consideration or other monetary benefit in exchange for making that arrangement.

Advertisements may contain statements of comparative credit costs, but any such statement must show costs for each alternative being compared, rates of interest and all other costs of credit for each alternative, and be accompanied by prescribed warnings concerning the use of such comparative statements.

10 Prevention of reckless credit

A consumer will be over-indebted if unable to meet their obligations under all their credit agreements.

A credit provider must not enter into a reckless credit agreement with a prospective consumer. This will be the case where a credit provider does not first take reasonable steps to assess the proposed consumer's general understanding of the risks and costs of credit, understanding of the rights and obligations under a credit agreement, debt repayment history and financial means.

A credit agreement is not reckless if the consumer failed to fully and truthfully answer any requests for information, and the consumer's failure to do so materially affected the ability of the credit provider to make a proper assessment.

If a court declares that a credit agreement is reckless it may make an order setting aside all or part of the consumer's rights and obligations under that agreement, or suspending the credit agreement. It must further consider whether the consumer is over-indebted. If so, it may suspend the credit agreement until a future date, and restructure the consumer's obligations under any other credit agreement.

During the period that the credit agreement is suspended the consumer does not have to make any payment. No interest or fee may be charged. The credit provider's rights under the agreement are unenforceable.

After the suspension, all the respective rights and obligations of the credit provider and the consumer under that agreement are revived.

11 Application for debt review

11.1 Debt counsellor

A consumer may for a fee apply to a debt counsellor for a debt review. The debt counsellor may request the consumer and each of his or her credit providers to participate in reviewing the consumer's indebtedness. The debt counsellor may also request them to participate in good faith in any negotiations designed to result in responsible debt rearrangement.

The debt counsellor must first determine whether the consumer appears to be over-indebted. If the consumer seeks a declaration of reckless credit, the debt counsellor must also determine whether any of the consumer's credit agreements appear to be reckless. If the consumer is not over-indebted, the debt counsellor must reject the application for a debt review, even if the debt counsellor has concluded that a particular credit agreement was reckless at the time it was entered into.

If the consumer is not over-indebted, but is experiencing difficulty satisfying all his or her obligations under credit agreements in a timely manner, the debt counsellor may recommend that the consumer and the respective credit providers voluntarily consider and agree on a plan of debt rearrangement. If the consumer and each credit provider concerned accept the recommendation, the debt counsellor must record it in the form of an order, and file it as a consent order. If the parties do not agree, then the debt counsellor must refer the matter to the magistrates' court, together with the recommendation.

If the consumer is over-indebted, the debt counsellor may issue a proposal recommending that a magistrates' court orders that one or more of the consumer's credit agreements is declared to be reckless credit; and one or more of the consumer's obligations is rearranged. Rearrangement can occur by extending the period of the agreement and reducing the amount of each payment; postponing the dates on which payments are due; extending the period of the agreement; or recalculating the consumer's obligations because of contravention of the National Credit Act.

11.2 Magistrates' court

On receipt of a recommendation by a debt counsellor, or on application by a consumer, a magistrates' court may make an order declaring any credit agreement to be reckless and order the rearrangement of the consumer's obligations.

A credit provider who receives notice of court proceedings to suspend a reckless credit agreement, or notice from a debt counsellor for a debt review, may not enforce any right under that credit agreement until the consumer fails to comply with the terms of a rearrangement agreed between the consumer and credit providers, or ordered by a court or the Tribunal.

Wesbank, a division of FirstRand Bank Ltd v Papier [7]

The court dealt with a credit agreement for the lease of a Mazda motor vehicle to be paid by monthly instalments. The debtor got into financial difficulties and applied for debt review with a debt counsellor. The debt counsellor sent notices informing the credit providers, including the bank, that the application for debt review was successful, that the defendant was over-indebted and that the defendant's obligations were in the process of being restructured. These notices were accompanied by an instalment offer. The debt counsellor launched an application for a court order that the defendant and his wife be declared over-indebted and that their debt obligations be restructured as proposed by the debt counsellor. Before it could be heard by the court, the bank notified the debtor that it was terminating the debt review process. The debtor was in arrears and the bank demanded immediate payment of the full amount due.

The court had to decide if it was legal for a credit provider to terminate a debt review process after an application has been lodged with a magistrates' court for an order restructuring a consumer's debts but before a court order has been made.

The court held that this kind of conduct was counterproductive and contrary to the purpose of the Act. A credit provider was not allowed to unilaterally terminate the consumer's protection at the precise moment when he may need it most.

12 Unlawful credit agreements

A credit agreement is unlawful if the consumer was an unemancipated minor unassisted by a guardian, or if it made by someone found by a court to be mentally unfit. It is unlawful if it resulted from an offer that it automatically came into existence unless the consumer declined the offer,

An agreement will also be unlawful if the credit provider was unregistered, or it was subject to a notice by the National Credit Regulator requiring it to stop offering, making or extending credit under a credit agreement.

13 Unlawful provisions of credit agreements

A credit agreement must not contain an unlawful provision. A provision of a credit agreement is unlawful if it:

- Is intended to defeat the purposes of the Act or to deceive the consumer.
- Tries to deprive a consumer or credit provider of any statutory or common-law rights and obligations.
- Results from an offer to increase the credit limit under a credit facility, or to amend a credit agreement, on the basis that the increase or amendment will automatically take effect unless the consumer rejects the offer.
- Makes the agreement subject to another agreement, which contains a provision that would be unlawful if it was contained in a credit agreement.
- Tries to exempt the credit provider from liability for any act, omission or representation by a person acting on behalf of the credit provider; or any guarantee or warranty that would be implied in a credit agreement.
- Acknowledges that before the agreement was made, no representations or warranties were made in connection with the agreement by the credit provider or a person on its behalf.
- States that the consumer has already received goods or services, or a document that is required by the Act to be delivered to the consumer.
- Agrees to forfeit any money to the credit provider if the consumer exercises the right of rescission, or fails to comply with a provision of the agreement before the consumer receives any goods or services.
- Appoints the credit provider, or any of its employees or agents, as an agent of the consumer for any purpose other than for payment of delivery or installation fees and charges.
- Authorises any person acting on behalf of the credit provider to enter any premises for the purposes of taking possession of goods to which the credit agreement relates.
- Grants a power of attorney in advance to the credit provider in respect of any matter related to the granting of credit in terms of the Act.

- Undertakes to sign in advance any document to enforce the agreement, irrespective of whether the document is complete at the time it is signed.
- Consents to a predetermined value of costs relating to enforcement of the agreement.
- Limits the credit provider's liability for court action.
- Consents to the jurisdiction of the High Court, if the magistrates' court has concurrent jurisdiction.
- Consents to the jurisdiction of any court outside the area of jurisdiction of a court having concurrent jurisdiction and in which the consumer resides or works or where the goods are ordinarily kept.
- Agrees to deposit with the credit provider or any other person an identity document, credit or debit card, bank account or automatic teller machine access card.
- Provides a personal identification code or number to be used to access an account.
- Authorises any person engaged in processing payments to give priority to payments for the credit provider over any other credit provider.
- Allows the credit provider to satisfy an obligation of the consumer by making a charge against an asset, account, or amount deposited by or for the benefit of the consumer and held by the credit provider or a third party.
- States that the rate of interest is variable. A credit agreement may provide for the interest rate to vary during the term of the agreement only if the variation is by fixed relationship to a reference rate stipulated in the agreement. This reference rate must be the same as that used by that credit provider in respect of any similar credit agreements currently being issued by it.

An unlawful provision is void. The court must either sever it from the credit agreement, or amend it to the extent required to render it lawful, or declare the entire agreement unlawful.

14 Further protections for consumers and credit providers

14.1 Pre-agreement disclosure

A credit provider must give the consumer a pre-agreement statement and quotation. In respect of intermediate or large credit agreements, the quotation must set out the principal debt, the proposed distribution of that amount, the interest rate and other credit costs, the total cost of the proposed agreement, and the basis of any costs that may be assessed if the consumer rescinds the contract.

14.2 Consumer must disclose location of goods

Until the termination of the credit agreement, the consumer must tell the credit provider of any changes in his or her residential or business address; the address at which the goods are ordinarily kept; the name and address of the landlord, if any; and the name and address of any other person to whom possession of the goods have been transferred.

14.3 Obligations of pawn brokers

A credit provider who enters into a pawn transaction with a consumer must specify in the credit agreement a date on which the agreement ends, and must keep the consumer's property until that date. The pawn broker must deliver the property back to the consumer if the consumer pays the settlement value before the end date.

Failure to make such delivery because the property was damaged or destroyed by a cause outside the control of the credit provider may result in compensation for double the fair market value of the property, less the settlement value at the time of failure to deliver that property.

14.4 Limits imposed on the costs of credit

The credit agreement may only require payment for the principal debt; an initiation fee; a service fee; interest (which must be expressed in percentage

terms as an annual rate calculated in the prescribed manner and must not exceed the applicable maximum prescribed rate); costs of any credit insurance; default administration charges; and collection costs.

The Minister of Trade and Industry is responsible for setting interest rates. From August 2006 interest rates on credit agreements were as follows:

Type of credit agreement	Maximum interest rate
Mortgage agreements	(RR × 2.2) + 5% (annual rate)
Credit facilities	(RR × 2.2) + 10% (annual rate)
Unsecured credit transactions	(RR × 2.2) + 20% (annual rate)
Other credit agreements	(RR × 2.2) + 10% (annual rate)

RR = Repo Rate as determined by the South African Reserve Bank, plus an initiation fee and a monthly service fee (R50.00)

Structured Mezzanine Investments (Pty) Ltd v Davids and others [8]

An investment company loaned R4 million to a property developer. The debt was secured by a suretyship. When the developer failed to make repayment, the lender sued the sureties for the full amount of the loan plus interest calculated at the rate of 1.5% per week as provided for in the agreement.

The court held that the National Credit Act which prescribed maximum interest rates and finance charges did not apply to the loan agreement as the principal debtor was a juristic person whose asset value or annual turnover was in excess of R1 million. Furthermore, the agreement was a large transaction. As the Act did not apply to the principal debtor it equally did not apply to the sureties.

14.5 Statements of account

A credit provider must offer to deliver to each consumer periodic statements in the prescribed form every month. However, this is extended to every two months in respect of an instalment agreement, lease or secured loan, and every six months in respect of a mortgage agreement.

At the consumer's request, a credit provider must deliver without charge a statement detailing the current balance of the consumer's account; any amounts credited or debited during a period specified in the request; any amounts currently overdue and when each such amount became due; and any amount currently payable and the date it became due.

Delivery may be made orally, in person or by telephone, or in writing, either to the consumer in person or by SMS, mail, fax, e-mail or other electronic form of communication.

A credit provider is not required to provide a further written statement if it has within the three previous months already given such a statement, or if the account was closed more than three years previously.

15 Termination of a credit agreement

There are four ways that a credit agreement may terminate.

15.1 Payment

Normally a credit agreement will terminate on payment of the full settlement amount and satisfaction of all conditions.

A credit provider must credit each payment made on the date of receipt, even if it is before the date on which the payment is due. Firstly, the interest charges are paid, followed by any other unpaid fees or charges. Whatever amount is left from each payment then goes towards reducing the amount of the principal debt.

15.2 Rescission

The withdrawal from an agreement is known as ‘rescission’. A cooling-off period of five days may apply, but only if the credit agreement was entered into at a location other than the registered business premises of the credit provider. The consumer then has only five business days after the date of signature to terminate the agreement without penalty. This is done by delivering a notice to the credit provider; and tendering the return of any money or goods, or paying in full for any services received by the consumer.

The credit provider must then refund any money the consumer has paid within seven business days after the delivery of the notice to terminate. The credit provider may require payment from the consumer for the reasonable cost of having any goods returned and restored to saleable condition; a reasonable rent for the use of those goods for the time that the goods were in the consumer's possession; and the depreciation of the goods.

15.3 Early settlement or early termination

The consumer can terminate the agreement at any time without notice to the credit provider by payment of the full settlement amount; or surrender of the goods, and payment of the remaining amount.

The amount required to settle a credit agreement is the total of the unpaid balance of the principal debt at that time; and the unpaid interest and other fees and charges up to the settlement date.

An early termination charge might also be payable in the case of a large credit agreement:

- At a fixed rate of interest: an early termination charge may be no more than a prescribed charge or, if no charge has been prescribed, a charge calculated at a rate other than at a fixed rate of interest.
- Other than at a fixed rate of interest: an early termination charge may be equal to no more than the interest that would have been payable under the agreement for a period equal to the difference between three months and the period of notice of settlement if any, given by the consumer.

If the consumer is in default, the credit provider can terminate the agreement by using the collection, repayment, surrender, and debt enforcement provisions of the Act.

15.4 Surrender of goods

A consumer who has the goods in his or her possession may request the credit provider to either sell the goods, or else the goods may be returned to the credit provider's place of business during ordinary business hours within five business days after being notified. A longer period may be agreed upon. Within ten business days after receipt of either the notice or the goods, the credit provider must give the consumer written notice setting out the estimated value of the goods. The consumer then has a further ten business days to change his or her mind, and to withdraw unconditionally the notice to terminate the agreement and to resume possession of any goods held by the credit provider.

The credit provider must sell the goods as soon as practicable for the best price reasonably obtainable. The consumer's account is debited or credited with the amount less any expenses reasonably incurred. The credit provider must give the consumer a written statement of all amounts. If money is still owed, the credit provider may demand payment from the consumer of the remaining settlement value.

If a consumer fails to pay within ten business days after receiving the notice of demand, the credit provider may start legal action for judgment

enforcing the credit agreement. Interest may be payable from the date of the demand until the date that the outstanding amount is paid by the consumer.

16 Debt enforcement by repossession or court judgment

If the consumer is in default under a credit agreement, the credit provider must provide a notice to the consumer. The notice must notify the consumer of the default, and propose that the consumer refer the credit agreement to a debt counsellor, alternative dispute resolution agent, consumer court or ombud with jurisdiction. The intention is for the parties to resolve any dispute under the agreement or develop and agree on a plan to bring the payments under the agreement up to date.

PRACTICALLY SPEAKING

Ten things to think about before your business gives credit[9]

1 **Do you need to extend credit to your customers?** Is it necessary to offer credit in your business, or are you able to operate profitably by requiring payment in cash?
2 **Will you accept cheques?** If your customer does not have money to cover the amount of the cheque, your customer's bank will 'bounce' the cheque (return it to you unpaid).
3 **Will you accept credit cards?** You do not take a very big risk by accepting credit cards if you are careful about following the credit card company's policies and procedures. When you accept a credit card as payment, your bank collects the money from your customer for you. In return, you pay the bank a fee for doing so, usually from two to six per cent of the bill for most small businesses.
4 **Will you offer credit terms?** 'Credit terms' means the amount of time you give your customer to pay your bill. The type of business that you operate will help determine the type of credit terms that you offer.
5 **How will you decide who gets credit?** You may decide that you will offer credit terms only to business customers, and require consumers to pay by cash or credit card. If you decide to offer credit to consumers, special laws apply, so consult your attorney first!
6 **How will you obtain credit information on your customers?** You may require a written application and financial statements to help make your credit decision, or obtain credit references or a credit report through an accredited credit bureau.
7 **A consumer may challenge the accuracy of information held by the credit bureau**: What procedures does your business have in place to deal with consumers who challenge your credit decision?
8 **How much credit will you offer?** Take reasonable steps to assess the customer's general understanding of the risks and costs of credit, understanding of the rights and obligations under a credit agreement, debt repayment history, and financial

means. The best approach is to offer a relatively low amount of credit at first. If your customer pays you as agreed over a period of time, you can increase that customer's credit limit.

9 **How will you 'bill' or invoice the customer?** Will your company send out the bills, or will you hire an outside company to do that for you? Remember that a credit provider must offer to deliver statements in the prescribed form to each consumer every month, or every two months for instalment agreements.

10 **How will you collect past due accounts?** It is best to set up collection procedures to follow before any accounts become delinquent.

THIS CHAPTER IN ESSENCE

1. The National Credit Act applies to most credit agreements in South Africa; however, some credit agreements are excluded.
2. There are three types of credit agreement: small, intermediate and large.
3. A credit provider may refuse to enter into a credit agreement on reasonable commercial grounds consistent with its customary risk management and underwriting practices. Reasons must be provided for any refusal.
4. A credit bureau may keep credit information about a consumer concerning credit history, financial history, education and employment history, and the consumer's identity.
5. If the consumer is experiencing difficulty in paying all his or her credit agreements, the debt counsellor may recommend that the consumer and the respective credit providers voluntarily agree on a plan of debt rearrangement. If they all agree, the debt counsellor records this in the form of an order, and files it as a consent order.
6. If a consumer is over-indebted, a debt counsellor may issue a proposal recommending that a magistrates' court declare one or more of the consumer's credit agreements to be reckless credit and the consumer's obligations be rearranged.
7. If a court declares that a credit agreement is reckless it may make an order setting aside all or part of the consumer's rights and obligations under that agreement, or suspending the credit agreement. If the consumer is also found to be over-indebted, the court may suspend the credit agreement until a future date, and restructure the consumer's obligations.
8. The Act also stipulates various unlawful provisions of credit agreements.

QUESTIONS

Short questions (1–5 marks)

1. List five credit situations in which the National Credit Act does NOT apply.
2. Distinguish between small, intermediate, and large credit agreements.
3. What is the name of the certificate for which a consumer may apply in a situation where the consumer's debts have been rearranged in terms of the National Credit Act?
4. When is registration as a credit provider compulsory?
5. In what official languages does a consumer have a right to receive documents?
6. What is reckless credit?

Paragraph questions (5 marks)

1. Discuss the role of the National Credit Regulator.
2. Discuss the role of the National Consumer Tribunal.
3. Outline the process for a consumer to access, challenge, and remove credit information.
4. Discuss what is meant by a debt review.
5. Distinguish between unlawful credit agreements, and credit agreements with unlawful provisions.
6. Discuss the protection offered to credit providers under the National Credit Act.

Essay questions (10 marks)

1. Discuss the protection of consumer rights as set out in the National Credit Act.
2. List ten provisions of a credit agreement that would be unlawful.
3. Discuss the process of debt review, including the role of a debt counsellor and the court.
4. Discuss four ways by which a credit agreement may terminate.

Problem questions (20 marks)

1. Peter buys goods from Sol for R2 000 subject to the National Credit Act. The agreement is entered into at Peter's home in Durban. Discuss the legal position in the following cases:
   a. Peter is an unemancipated minor.
   b. The contract is not in writing.

c. Sol lends Peter the money to pay the deposit.
d. Peter fails to make payment of an instalment on time.
e. Sol is an unregistered credit provider.
f. The agreement exempts Sol from liability for any representation made about the goods.
g. The agreement consents to the jurisdiction of the High Court in Cape Town.
h. The agreement states that interest is charged at a rate of 30% per month.
i. The agreement states that interest is charged at a rate of 2% per day, compounded.

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1 National Credit Act 34 of 2005.

2 Consumer Protection Act 68 of 2008.

3 National Credit Act 34 of 2005.

4 *Firstrand Bank Limited v Carl Beck Estates (Pty) Ltd and another* 2009 (3) SA 384 (T).

5 Constitution of the Republic of South Africa, 1996.

6 Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000.

7 *Wesbank, a division of FirstRand Bank Ltd v Papier* (WCC) (unreported case no 14256/2010, 1-2-2011).

8 *Structured Mezzanine Investments (Pty) Ltd v Davids and others* 2010 (6) SA 622 (WCC).

9 Source: www.smallbusiness.findlaw.com/business-operations/debt-collection-credit, accessed 14 August 2008. Copyright © 2008 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 18

Lease and occupancy

'The clearest way to show what the rule of law means to us in everyday life is to recall what has happened when there is no rule of law.'

DWIGHT D. EISENHOWER (1890–1969)
SUPREME COMMANDER OF THE ALLIED FORCES IN EUROPE DURING WORLD WAR TWO, AND 34TH PRESIDENT OF THE UNITED STATES OF AMERICA

What is covered in this chapter

1 Definition
2 Essential elements
3 Formalities
4 Common-law duties of the landlord
5 Common-law duties of the tenant
6 Remedies
7 Termination
8 Rental Housing Act
9 The Consumer Protection Act
10 The Land Reform (Labour Tenants) Act
11 The Extension of Security of Tenure Act
12 The Prevention of Illegal Eviction from and Unlawful Occupation of Land Act
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Every person needs a place to live and to keep their things safely. Similarly, businesses need premises from which to trade. Everyone at some point in their lives will probably enter into a contract of lease. It is therefore important for you to know what a lease agreement is, and how it is different to sale.

You must also understand what your rights and duties are if you are a tenant or a landlord, so that you can enforce your rights and defend any claims made against you.

1 Definition

A lease is a contract between two persons, the landlord (or lessor) and the tenant (or lessee), for the letting by the former and the hiring by the latter, of specified immovable property, in terms of which the landlord grants the temporary use and occupation of the property to the tenant for a period in time in return for a specific sum of money (or a share in the proceeds or fruits of the property) called rent.[1]

A lease is different from a sale. In a lease, the landlord allows the tenant to use the property. In a sale, the seller intends to transfer every right the seller has in the thing, including the right to use it up or destroy it.

2 Essential elements

There are three essential elements in any valid contract of lease.[2]

2.1 Specified immovable property

The parties must agree on the particular subject matter of the contract, i.e. the property to be rented. If the subject matter of the lease is not identifiable the contract will be void.[3] If movables are situated on the property they are not automatically included in the lease.[4]

The landlord does not need to be the owner of the property. It is sufficient if the landlord is able to give the tenant the use and enjoyment of the property and its proceeds or 'fruits'. Tenants do not have the right to take away the substance of the land or to destroy it. For example, a contract to rent property that includes the right to cut down trees, which renew themselves, is a lease. However, a contract to rent property that includes a right to remove minerals is not a lease, since these do not replenish themselves.[5]

***Bozzone and others v Secretary for Inland Revenue*[6]**

The appellant was disputing a tax ruling over a contract entered into with the local council. The contract referred to itself as a lease. And would allow the appellant to mine stone, gravel and sand in exchange for a monthly rental. The tax office argued that the agreement gave the appellant real rights in the property and required the payment of transfer duty.

The court held that because the appellant was consuming the materials of the property, the agreement was not a lease, and found in favour of the tax office.

2.2 Duration of the lease

The parties do not intend the tenant to have the use of the property permanently, but only for a fixed period. The intention can be communicated either explicitly or implicitly.

The period may be indefinite if it is left up to the parties to terminate on notice.[7]

A lease may continue under the common law as follows:

- **For a definite period of time**: The lease ends automatically on the expiry of this fixed-term period.[8]

  The common-law situation has been changed by the Consumer Protection Act[9] which applies only to certain leases.

  For this Act to apply, the lease must be entered into as a part of the landlord's regular business, and not be a one-off contract. The Act will not apply to transactions between juristic persons; however, it does apply to transactions involving at least one natural person.

  Where the Act applies it limits the duration of a fixed-term lease to a maximum of two years, unless the landlord can show a demonstrable financial benefit to the tenant for a longer period.
- **Until a specified event occurs**: The lease is automatically terminated on the occurrence of the event.[10]
- **From period to period**: For example, weekly or monthly. The lease is terminated on notice. The notice period is either expressed in the contract or a reasonable period will be determined by the court, based on the frequency of payment of rental. A reasonable notice period for a monthly tenant is one month, calculated from the beginning of the monthly period.[11] In respect of an annual tenancy, three months' notice would be reasonable.
- **Terminating at the will of the landlord**: No notice is required. The lease terminates automatically on the landlord's death.
- **Terminating at the will of the tenant**: The landlord may not terminate this type of lease, even on giving notice. The landlord may terminate only on the breach of the lease by the tenant.

> ***Friedman v Friedman***[12]
>
> A landlord let a house to a tenant for as long as the tenant wanted, at a certain rental per month. The tenant later refused to vacate on being given one month's notice.
>
> The court found in favour of the tenant.

The common-law situation has been changed by the Consumer Protection Act[13] regarding lease transactions involving at least one natural person. No matter what fixed-term is stated in any written or verbal lease agreement, a tenant may cancel a fixed-term lease before its expiry by giving the

landlord 20 business days' notice in writing. In terms of the Act the tenant will not be in breach of contract.

The landlord will be entitled to any outstanding amount owed, as well as a reasonable cancellation fee. What is ‘reasonable’ depends on the amount owed; the value of the transaction up to the date of cancellation; the value of the lease; the duration of the contract; the losses suffered or benefits accrued by the tenant; the length of notice of cancellation provided by the tenant; the reasonable possibility for the landlord to find an alternative tenant; and the general practice of the relevant industry.

A lease may be renewed expressly or tacitly as follows:

- **Express renewal**: The original lease may contain an option to renew the lease during its currency. This gives the tenant the right to renew on the expiry of the original lease. To exercise this right to renew, the tenant must comply strictly with the option clause.[14] This is known as ‘conventional relocation’.
- **Tacit renewal**: The landlord simply allows the tenant to stay in occupation after termination of the lease and continues to take rent for the use and enjoyment of the property.[15] This is known as ‘tacit relocation’.[16]

Pareto Ltd and others v Mythos Leather Manufacturing (Pty) Ltd [17]

A contract of lease was entered into for a period of 30 months. Towards the end of the period, negotiations began regarding another contract of lease but no agreement was reached. Before expiry, the landlord notified the tenant of the date that the agreement would expire. After the contract expired, the landlord allowed the tenant to remain in occupation and to pay rent. After a further period of four months, the landlord gave one month's written notice to vacate the premises.

The court held there had been a tacit relocation of the lease. The lease was terminable on reasonable notice. The tenant had to leave.

There will be no tacit relocation if either party lacks capacity. For example, if the landlord dies or becomes insane without a curator.

Under the common law, special clauses in previous leases are not tacitly renewed.[18] However, in terms of the Rental Housing Act,[19] special clauses in respect of leases for dwellings will be tacitly renewed.

Under the Consumer Protection Act,[20] regulations provide for a maximum term for any fixed-term lease covered under the Act. On expiry of the fixed-term, the lease is continued on a month-to-month basis until the tenant cancels it or agrees to another fixed-term. This section of the Act does not apply to transactions between juristic persons; however, it does apply to transactions involving at least one natural person.

2.3 Specified rent

The tenant must pay a specified sum of money or a share of the proceeds or 'fruits' of the property.[21] If the rent consists of a certain quantity of agricultural produce, the tenant is called a *bywoner*. If no money is payable, the agreement is one of a loan for use. Occupation in exchange for labour is not a lease.[22]

A definite rent that can be calculated must be agreed upon, or a manner of determining that amount, or else there is no valid lease.

***Birkenruth Estates (Pty) Ltd v Unitrans Motors (Pty) Ltd (formerly Malbak Consumer Products (Pty) Ltd) and others*[23]**

The parties had entered into a lease agreement in terms of which the rentals for the first five years of the contract were stated, but the rentals for the second five-year period were to be determined through a detailed procedure set out in the contract. The tenant moved out of the premises after the first five years and the landlord sued for damages for the second five-year period.

The tenant argued that the landlord failed to give notice which would have set the rent-review process in motion, and that this failure entitled the tenant to regard the agreement as cancelled, and therefore there was no enforceable lease for that period.

The court held that where a clause in a contract provides that a party 'shall do something by a specified time', failure to do so would put that party in default. The mere failure to perform timeously does not entitle the innocent party to cancel the contract. Breach of contract through failure to perform timeously gives the innocent party no more than a claim for damages or for specific performance or both. The innocent party is entitled to resile, as opposed to claim damages or specific performance, only when in addition to the default or breach of a material term, time was of the essence for performance. The right of cancellation may also arise in a contract where the time for performance of a material term had been stipulated and the debtor had not performed by the stipulated date when the contract contained a cancellation clause.

The court held that the indications were overwhelming that the parties intended the lease to be a ten-year lease. A failure by the landlord to give a notice which would have set the rent-review process in motion did not by itself result in the lease agreement terminating.

The parties either must fix the amount of the rent or agree on a formula by which the rent can be worked out without reference to the parties. They may even agree that a third party must determine the rent.

Trook t/a Trook's Tea Room v Shaik and another [24]

An oral lease was entered into. It was alleged that there had also been an oral option to renew the lease, which contained a tacit term that the rent would be reasonable.

The court held that a term in a lease to pay a 'reasonable rental' was void for vagueness.

It can be problematic when, in addition to a fixed rental, tenants have to pay maintenance charges for the upkeep of the building. These amounts obviously cannot be calculated at the time the lease is entered into. The courts have held that these do form part of the lease, and that unless they are specified or ascertainable, the lease concerned is unenforceable, since the determination of the amounts payable is primarily at the instance of the landlord only.[25]

The rent must normally be in the form of money, and must constitute something for value in exchange for the use of the thing. This is known as a *quid pro quo*.[26]

Southernport Developments (Pty) Ltd v Transnet Ltd [27]

The parties had not expressly agreed on the amount of the rent in a contract of lease. Instead, the contract granted one party the option to lease property on terms and conditions to be negotiated between the parties in good faith. It also contained an arbitration clause that stated any dispute would be referred to arbitration and the decision of the arbitrator would be final and binding.

In this case Transnet argued that there was no agreement between the parties as to the essential terms of the lease and that it was therefore an unenforceable agreement.

The court held that the parties to a lease agreement could validly agree that the rent be determined by a particular arbitrator, and that any other terms could also be determined by a third party. The failure to agree on any term of the lease agreement constituted a dispute and could therefore be referred to arbitration, which would be final and binding.

3 Formalities

Generally, no formalities are required for an ordinary lease. The lease need not be in writing, although written leases are obviously easier to prove. The ordinary rules of contract apply.[28]

One exception is provided in the Rental Housing Act,[29] in terms of which a landlord of a dwelling must provide a written lease if requested by the tenant to do so. The failure of the landlord to do so is an offence that may make the landlord liable for a criminal conviction of up to two years' imprisonment, or a fine.

With regard to commercial leases, a long-term lease for a period longer than ten years does not have to be registered to be valid between the parties. However, registration is required if the lease is to be enforceable against a creditor or a successor under onerous title of the landlord (such as a subsequent purchaser). This is the case only if that person did not have knowledge of the lease at the time he or she became a creditor or onerous successor. The requirement for registration is not required in respect of long-term leases for dwellings.[30]

4 Common-law duties of the landlord[31]

4.1 Delivery of the use and occupation of the leased property at the time agreed upon

The landlord must give the tenant free and undisturbed possession of the property. If the property cannot be used without some other thing, such as a right to travel over land next to the property, then the landlord must ensure that the tenant also has use of the other thing.[32]

The property must be delivered in a reasonable state of repair under the circumstances, both internally and externally.[33]

If a tenant has entered into a contract of lease and is prevented from using the rights of occupancy because the landlord has let the property to a second tenant, the landlord may be sued by the first tenant for specific performance and damages. This means that the landlord must find a way to evict the second tenant, install the first tenant in occupation, and make good the first tenant's damages. If the second tenant is in good faith and the landlord is unable to cancel the second lease, the first tenant may cancel the contract with the landlord and sue the landlord for damages.

4.2 To maintain the property

The landlord must also continue to keep the property let in a proper condition, which means it must be reasonably fit for the purposes for which it was let. The landlord must maintain the property both externally and internally during the lease, that is, repair all flaws that interfere with the tenant's use of the property.[34] This duty extends to repairs to structural or other flaws, and preventing the property from becoming dilapidated.[35]

The tenant may waive his or her common-law rights to require the landlord to repair and maintain the property, either explicitly in a contract or agreement or impliedly by conduct. If a tenant agrees to maintain a property, this does not mean that the landlord is relieved of the duty to deliver the property in a proper state of repair. The tenant can do the repairs himself or herself and recover the costs.[36]

Harlin Properties (Pty) Ltd v Los Angeles Hotel (Pty) Ltd [37]

A hotel was leased. On taking occupation it was found that there were ugly cracks in various walls, floors, and ceilings; surfaces in the passages were chipped; and the floor of the kitchen was badly worn. The cracks let in rain, which discoloured the walls and ceilings. Due to this, a number of rooms were unfit for use.

The court held that the landlord had failed to deliver the leased premises in a condition fit for the purposes for which the parties had entered into the lease agreement.

On the failure of the landlord to maintain the premises in a fit state of repair, the tenant may choose any of the following three remedies:

- Cancel the lease and vacate the premises.[38]
- Recover damages for the breach of the lease, and consequential damages if the landlord had actual or imputed knowledge of the defect and could have repaired it.[39]
- Demand a reduction in the rent proportionate to the loss of use.[40]

The landlord is not liable for damages caused by the negligence of the tenant or by persons for whom the tenant is responsible.[41]

4.3 To protect the tenant against interference in the use of the property

The lease creates an implied warranty that the tenant will not be disturbed in his or her possession by either the landlord or any third party during the period of the lease for the purposes for which the premises were let.[42]

The landlord must not do anything directly or indirectly that interferes with the tenant's use and enjoyment of the property, and must ensure that another person who claims superior title to the property, for example the holder of a mortgage, does not evict the tenant.[43]

The landlord is not in breach of contract if a neighbour or another tenant interferes with the tenant's use and enjoyment. The landlord is not in breach of contract if he or she enters the premises to make necessary repairs. He or she will be disturbing the tenant if the repairs are merely useful and not necessary.[44]

Soffiantini v Mould [45]

The tenant of a hairdressing salon objected to the landlord entering the premises without his consent. The landlord also had ordered the lift attendant out of the lift and the staff and customers to leave, and had attempted to disconnect the electricity supply to the lift.

The court found the landlord guilty of breaching his duty to provide the tenant with use and occupation of the leased premises.

The landlord is not disturbing the tenant's use and enjoyment of the property if he or she enters the premises from time to time to inspect the premises. These powers of inspection must be carried out reasonably. The landlord should inspect only at reasonable hours and give the tenant reasonable advance notice of inspections.

If an act of God or some other unavoidable action that the landlord reasonably could not have foreseen prevents the landlord from ensuring that the tenant has undisturbed use and occupation, the tenant's duty to pay the rent is proportionately reduced to the degree of the deprivation.[46]

If the tenant is evicted from use and occupation of the premises, then he or she may refuse to pay further rent, and may sue for damages to place him or her in the position he or she would have been in had the lease been properly performed.[47]

5 Common-law duties of the tenant[48]

5.1 To pay the rent

Rent must be paid in money, unless there is an explicit agreement to share in the ‘fruits’ of the property. For example, a percentage of a harvested crop on a farm.

Rent must be paid in the manner explicitly agreed upon. If there is no explicit agreement, then the tenant must take steps to pay the landlord on or before the due date, at a reasonable place.[49] The tenant may demand a receipt and may refuse to pay the rent until he or she receives one.[50]

In the absence of an agreement to the contrary, rent is normally paid ‘in arrears’. This means that the rent must be paid at the end of each lease period, such as the end of the month.[51] Where a day is agreed for payment, the tenant has until midnight on that day to make payment of the rent.[52]

If the place of payment is closed because it is a Sunday or public holiday, then the tenant may make payment during business hours on the next business day.[53] Payment of rent at any place other than the place agreed upon is not acceptable, even if it is to an agent authorised to receive payment.[54] In the absence of an agreement as to where payment must be made, then if the parties have an agreed time for payment, the tenant must seek out the landlord and pay him or her. If a payment is sent, but does not reach the landlord, the tenant will be in breach.[55]

If no fixed time for payment has been agreed, then the landlord must seek out the tenant and obtain payment from him or her. Once the landlord demands payment within a specified time, the tenant then must seek out the landlord by the time specified and pay him or her.[56]

If the landlord, over a long period of time, has accepted late rental payments without objecting, the landlord may be prevented from cancelling the lease due to a late payment, unless the landlord gives the tenant reasonable notice that, in future, the landlord will keep strictly to the contract.[57]

Surprisingly, under the common law, the failure to pay rent was not a material breach enabling the landlord to cancel the lease! Under the common law, a landlord could cancel a lease only after two years of rent arrears, and then only after notice to the tenant. The payment of rent was seen as a duty arising out of the contract of lease; it did not form an essential element of the contract.

However, the common-law position has been modified by the case of *Goldberg v Buytendag Boerdery Beleggings (Edms) Bpk*.[58] As a result of this case, in circumstances where a tenant fails to pay rent, the landlord may demand payment within a reasonable time. Failure by the tenant to pay within this time renders him or her in breach and enables the landlord to cancel the lease.

An easier solution for the landlord is to insert a cancellation clause in a lease, which enables the landlord to cancel the lease on non-payment of rental.

The situation in respect of residential properties finally has been addressed by the Rental Housing Act[59] relating to the rights of the landlord for prompt and regular payment of any rental and charge in terms of the lease.

If the tenant is not able to use the property as a result of an act of God or some other unavoidable situation, for example flood, fire, riot, or an act of the State, the tenant does not have to pay rent from the date on which his or her use was prevented.[60]

Bayley v Harwood [61]

The tenant conducted a health and pleasure resort on the leased premises. New by-laws were introduced that required the landlord to make structural alterations. The landlord refused to do so. The tenant left the premises and paid rent up to the date it left.

The court held the tenant had been prevented from using the premises because of the by-laws, and was entitled to pay no rent from the date they left.

5.2 To ensure that the property is not misused and is used only for purpose for which it was let

If there is an express agreement as to the use of the property, it only may be used for those purposes. In the absence of an express agreement, the

property only may be used for the same purposes it was used before the lease.[62]

If the tenant uses property unreasonably or improperly, an action for damages can be brought against the tenant. For example, the tenant may not use residential premises for business purposes. Living an immoral private life does not constitute misuse of the premises.[63]

Lomax v Killarney of Durban (Pty) Ltd [64]

A landlord applied to court to cancel a lease as it was alleged that the tenant was using the premises to have sex with women to whom he was not married.

The court held that the conduct complained of was not a misuse of the premises, and refused to allow the landlord to cancel the lease.

Oatorian Properties (Pty) Ltd v Maroun[65]

A written lease agreement provided that a tenant was allowed to use the leased premises only for parking motor vehicles and motorcycles and for no other purpose. The tenant had in fact erected a wooden shed on the leased premises.

The court held that this amounted to a breach of the lease, which in terms of the lease agreement entitled the landlord to cancel the lease.

5.3 To return the property undamaged at the end of the lease

The tenant must exercise the degree of care that a reasonable person would observe in using his or her own premises.[66] The property must be returned in the same condition it was in at the beginning of the lease.[67] The tenant is not liable, however, for ordinary wear and tear, or damage caused by someone for whom he or she was not responsible.[68]

An agreement that the tenant will keep the property in good repair does not relieve the landlord of the duty to repair structural flaws.[69] An acknowledgement by the tenant that he or she received the property in good order and condition does not relieve the landlord of the liability to repair structural defects that were not apparent at the time the premises were delivered.[70]

Similarly, where the tenant agrees to return the premises in the same good order and condition he or she received them in, the tenant is not liable for damage caused by an act of God or some other unavoidable situation

which could not have been foreseen by the parties at the time the contract was entered into.[71]

A tenant failing to return the property at the end of the lease is said to be ‘holding over’ and may be evicted only with a court order.[72]

If the tenant returns property in a damaged condition, the tenant must prove that neither the tenant nor any person for whom he or she is responsible caused the damage. Otherwise, the tenant will be liable to the landlord for damages.[73]

6 Remedies

Ordinary remedies for breach of contract apply.[74] If the breach is material, the aggrieved party has the choice either to keep to the lease, sue for specific performance and claim any damages suffered, or to cancel the lease and sue for damages. If the breach is not material, the aggrieved party may claim damages only.

6.1 Remedies of the tenant

6.1.1 The landlord breaches the duty to deliver

It is a material breach where the landlord does not deliver the property at all.

Where the property is delivered but it is not in a proper state of repair, it is a matter of fact whether or not the breach is material. If the breach is material, the tenant may cancel the lease and sue for damages. If it is not material, then the tenant may claim damages only in the form of a proportionate deduction of rent. The tenant, after prior notice to the landlord, also may arrange for the repairs and deduct the costs of the repairs from the rent.

The landlord is liable to compensate the tenant for damage caused to the tenant's property on the leased premises as result of any defects. However, in that case, the landlord must have had actual or implicit knowledge of the defect's existence and had an opportunity to act on that knowledge to remedy the defect. Implicit knowledge means that the landlord ought to have known of the defect because of his or her trade or profession.

6.1.2 The landlord fails to maintain the property in proper repair

The tenant may cancel the contract of lease and sue for damages, or claim specific performance and damages.

6.1.3 The landlord is in breach of the warranty

against interference

The tenant may claim damages, obtain an interdict, or choose to cancel the contract and claim damages.[75]

6.1.4 Hire takes precedence over sale

When the landlord sells the premises one would expect the lease to lapse. After all, the contract of lease was entered into with the original landlord, not the new landlord. The new landlord should in theory be able to evict the tenant, whose remedy would lie in a damages claim against the original landlord. The problem is that the original landlord is not the person evicting the tenant!

In South African law, the principle of 'hire takes precedence over sale' applies. This is also known as *huur gaat voor koop*. The effect is that the sale of the property cannot prejudice the tenant, since the buyer at the time of the sale had actual, or constructive, notice of the lease. The new owner simply 'steps into the shoes' of the original landlord. This means that the new landlord acquires all of the rights of the original landlord, and also acquires all of the duties. The original landlord is no longer liable under the lease.[76]

***Mignoel Properties (Pty) Ltd v Kneebone*[77]**

A landlord sold a building to a new owner. The new owner sued a person who had signed as surety and co-principal debtor for the tenant, who had failed to pay the rent.

The court held that the new owner stepped into the shoes of the previous lessor, and had acquired all of the rights held by the previous owner.

The 'hire takes precedence over sale' principle does not apply to leases of movables. It also does not apply where the property is expropriated by the State.

***Stellenbosch Divisional Council v Shapiro*[78]**

Property in respect of which a tenant had a lease agreement was expropriated.

The court refused the tenant to use the 'hire takes precedence over sale' principle to defeat the expropriation.

Importantly, the principle will only apply in respect of terms that comprise the lease agreement itself. Accordingly, a new landlord will not be bound by an option clause because this is not related to the contract of lease itself.[79]

In respect of leases less than ten years, the new landlord will only be bound if he or she knew of the lease, or if the tenant is in occupation of the premises. For leases longer than ten years, the new landlord will only be bound if he or she knew of the long lease, or if the lease is registered against the title deeds of the property.[80]

6.1.5 Compensation for improvements

Unless otherwise agreed, the tenant, during the currency of the lease, may remove all improvements he or she has made, other than those necessary for the protection or preservation of the property. However, the tenant may not remove them after the termination of the lease.[81]

Under the common law, the 1658 *Placaat of the Estates of Holland*[82] is still binding in South Africa. In terms of this edict, a tenant may remove useful improvements made to the premises or claim compensation for them in respect of leases over rural property. This right applies only to useful improvements that were made with the landlord's express or tacit consent and not to those that may have been necessary for the protection of the property. The tenant's right of removal is limited by the ability to remove the improvements without damaging the property. Once the lease ends, the improvements become the property of the landlord and the tenant's right of removal terminates.[83]

Burrows v McEvoy [84]

A tenant of a house planted some plants in the garden and, before the termination of the lease, uprooted the plants without causing any damage to the leased premises.

The court held that he was within his legal rights to do so and that the landlord was not entitled to any damages.

In the absence of a contrary agreement, the tenant is able to claim compensation for certain improvements made to the property. The tenant may claim compensation only once the lease has terminated and he or she

has vacated the premises. The tenant may not retain occupation until such time as the landlord pays compensation.[85]

Business Aviation Corporation (Pty) Ltd and another v Rand Airport Holdings (Pty) Ltd [86]

The parties had entered into an oral lease over part of an airport. Some time later, the lessee was then served one month's notice of termination. The lessee refused, and argued that as it had not been compensated for necessary and useful improvements made to the property it could not be required to vacate.

The court examined the role of the 1658 and 1696 *Placaaten of the Estates of Holland*. It held that these edicts never applied to urban leases. As the lease in this case was an urban one, there could be no claim for the recovery of expenses incurred in making necessary and useful improvements to the property. The tenant was required to vacate.

Compensation is awarded only where the improvements were made with the landlord's consent, and only according to the breakdown value of the improvements. This provision is obviously not very generous. The protection offered to a tenant by the 1658 edict is much less than the protection offered to a possessor in good faith. The possessor in good faith may claim compensation for useful improvements, either to the extent to which the value of the property has been enhanced, or for the actual expenditure, whichever is the less.[87]

Von Holt v Bruwer [88]

Farm tenants, with the consent of the landlord, had cleared an area of land, put up wire fencing, and raised the height of walls.

The court held they were entitled only to compensation for the value of the wire and metal poles for the fencing.

The tenant may claim for the following under the 1658 edict:

- **Necessary improvements**: Compensation is limited to the actual expenditure. This may include labour costs.[89]
- **Ploughing and cultivation on agricultural land**: Compensation is limited to the costs of the work and the seed.[90]
- **Structures erected with the landlord's consent**: This includes building, fences, dams, or even irrigation systems. Compensation is limited to the costs of materials, excluding the costs of materials taken

from the landlord's property, for example the costs of sand, timber, and stone.[91]

- **Trees or orchards planted with the landlord's consent**: Compensation is limited to the costs of the trees at the time of planting.[92]

This issue is discussed further in this text in chapter 20 on security, under the section on enrichment liens.

6.2 Remedies of the landlord

6.2.1 The tenant does not pay rent

Under the common law the landlord could not cancel a lease unless the tenant was two years in arrears with the rent, unless there was a cancellation clause. This obviously was not fair.[93]

The common-law situation no longer applies. In terms of the Rental Housing Act,[94] the landlord may give notice to a tenant of the landlord's intention to cancel the contract if payment is not made to him or her within a reasonable time. After this notice has been given, the tenant's failure to pay the rent due will entitle the landlord to cancel the contract.[95]

A cancellation clause is an express term allowing the landlord to cancel the contract of lease on the breach of specified terms of the lease. It is possible for a landlord to waive his or her right, explicitly or implicitly, to cancel under a cancellation clause. The court will examine whether the landlord's conduct is such that a waiver can be implied, for example if he or she has accepted late payments in the past.[96]

The landlord has a ‘tacit hypothec’ over any movables on the leased premises. This means that the landlord has a real right of security over the movables without any formality or notice to the public.[97] The landlord exercises the hypothec by instructing the deputy sheriff to attach the movables and remove them from the leased premises as a form of security for outstanding rent. Once removed lawfully, in legal terms we say that the hypothec was ‘completed’ or ‘perfected’. Once the hypothec is perfected, the landlord will be given a preference over the proceeds of the movables if they are sold to pay the debts of the tenant.

The tacit hypothec is lost if the goods are removed from the leased premises prior to attachment. The hypothec may be re-established by the landlord exercising his or her right of quick pursuit by following the goods and having them attached while they are still in transit. While the goods are on the leased property, the landlord may obtain an interdict to prevent the tenant from removing them.[98]

The tacit hypothec may be used with regard to all goods brought onto and carried into the leased property (even money), provided they belong to the tenant or a third party.

The landlord may only exercise this tacit hypothec over goods belonging to persons other than the tenant if all of the following requirements have been met:[99]

- The goods are on the property with the implicit or explicit consent or knowledge of the owners.
- The goods are there for the use of the tenant.
- The landlord had no knowledge that they belonged to a third party.
- The goods are on the leased premises with some degree of permanence.

These requirements are important where the tenant buys goods under a credit agreement, in which an express term provides that the seller remains the owner until the last payment has been made. These goods also are subject to the landlord's tacit hypothec while on the premises, unless the seller makes it clear to the landlord that the seller does not consent. That means the landlord must be notified by the shop that it does not wish its goods to be subject to the tacit hypothec.

6.2.2 The tenant misuses the property

Ordinary contractual remedies apply. If the misuse was a material breach of contract, the landlord will be entitled to cancel the contract and eject the tenant, with or without damages. To cancel the contract, the misuse must be markedly serious and ruinous. Alternatively, the landlord may apply to court for an interdict to prevent the tenant from misusing the property, or for an order of specific performance, to compel the tenant to comply with his or her obligations under the contract.[100]

If the misuse did not constitute a material breach of the contract, the landlord will be entitled to sue for damages only. The landlord may also apply to court for an interdict.

6.2.3 The tenant fails to return the property at the end of the lease (holds over)

The landlord will be entitled to eject the tenant as a trespasser by due process of law, and claim damages. However, the landlord may waive his or her rights and allow the tenant to remain in occupation. As discussed above, tacit relocation refers to the agreement that is implied between the parties to renew the relationship of landlord and tenant. A new lease, based on the terms and conditions of the original lease, is implied from the conduct of the parties. The original lease is terminated. In future, however, the new lease will terminate only on the giving of notice, even if the original lease was for a specified period.

6.2.4 The tenant returns the property in a damaged state

The landlord may claim damages unless the tenant can prove that the injury was not caused by the tenant's negligence or wrongful act, or by the negligent or wrongful act of a person for whom he or she is responsible.

7 Termination[101]

Leases are terminated in the same way as other contracts. A contract of lease may terminate on the occurrence of any of the following events:

- **Expiry of the lease period**: Under the common law, notice of termination is not required.[102] This situation has now been changed for leases falling under the Consumer Protection Act,[103] where a landlord must provide notice of termination to the tenant when the lease is ending, even if the period is set out clearly in the lease agreement. Under that Act, a fixed-term lease may only operate for a maximum period of two years. On expiry of the fixed-term, the lease is continued on a month-to-month basis until the tenant cancels it or agrees to another fixed-term.
- **Notice**: The period of time of notice depends on the facts of each case. Notice of termination is a unilateral act that requires no acceptance. Once given, it cannot be withdrawn without the consent of the other party.[104]
- **Death**: Generally a lease will not terminate on the death of either party. However, a lease at the will of the tenant will terminate on the death of the tenant. Similarly, a lease at the will of the landlord will terminate on the death of the landlord.
- **Insolvency of the tenant**: The lease is not terminated by the insolvency of either tenant or landlord. However, in terms of the Insolvency Act,[105] the trustee of the tenant's insolvent estate may terminate the lease on written notice. If within three months of the trustee's appointment, the trustee fails to notify the landlord that he or she wishes to continue the lease on behalf of the estate, the trustee is deemed to have terminated the lease at the end of the three-month period.

8 Rental Housing Act[106]

The Act varies the common-law positions of both landlord and tenant. The Act is meant to ensure the proper functioning of the rental housing market by protecting both landlords and tenants against unfair practices. It also creates a Rental Housing Tribunal to regulate relations between landlords and tenants.

The Act only applies to property rented for dwelling purposes. The definition of ‘dwelling’ under the Act includes any house, hostel room, hut, shack, flat, apartment, room, outbuilding, garage, storeroom, or demarcated parking space that is leased.

8.1 Rights of the parties

- **Prohibition against unfair discrimination**: In advertising or negotiating a lease for a dwelling, or during the lease period of a dwelling, the landlord may not discriminate unfairly against a tenant or prospective tenant, on any ground, including race; gender, sex, pregnancy, marital status, sexual orientation, ethnic or social origin, colour, age, disability, religion, conscience, belief, culture, language or birth.
- **Landlord's rights against the tenant**: The landlord's rights include the right to prompt and regular payment of rental or any charges payable in terms of the lease; to recover unpaid rental; to terminate a lease on grounds that do not constitute an unfair practice; to have the dwelling returned in a good state of repair on termination of the lease; to repossess the dwelling after obtaining a court order and to claim compensation for damages to the dwelling or improvements on the land, if caused by the tenant, or the tenant's family or visitors.
- **Tenant's right to privacy**: The landlord may only exercise his or her rights of inspection regarding the lease in a reasonable manner and after reasonable notice to the tenant. The tenant's right to privacy against the landlord includes the right not to have his or her person or dwelling or property searched; not to have his or her possessions seized, and the right not to have the privacy of his or her communications infringed.

These rights also apply to members of the tenant's household and visitors.

Any person who interferes with any of these rights is guilty of an offence, with liability for a criminal conviction of up to two years' imprisonment or a fine.

8.2 Contents of a lease for dwelling purposes

The landlord is responsible for ensuring that every lease for dwelling purposes contains the names and addresses of the tenant and the landlord and a description of the leased dwelling. It must also have the amount of rental and any reasonable escalation. Also, the details of any charges payable in addition to the rental, and frequency of rental payments. If not specified, then the rent must be paid monthly.

The lease must set out the amount of any deposit, as well as the lease period. If the lease period is unspecified, then the notice period for termination of the lease must be stated. The lease must also set out the obligations of the tenant and the landlord. None of these may be an unfair practice.

A list of defects must be attached as an annexure to the lease, as well as a copy of the ‘House Rules’ (if any) applicable to the dwelling.

The failure by the landlord to ensure that the lease contains all the above terms is an offence with liability for a criminal conviction of up to two years' imprisonment or a fine.

Every lease is automatically deemed to include the following terms which cannot be waived by the tenant or the landlord:

- **Receipt for all payments**: The landlord must provide a written receipt for all payments received from the tenant. The receipt must be dated, state the street address, and describe the property. It also must state whether payment was made for rental, arrears, deposit or otherwise, and specify the period for which the payment was made.
- **Deposit**: The landlord may specify a deposit to be paid before the tenant moves in. The deposit must be placed into an interest-bearing account with a financial institution at a rate not less than that for a savings account.

On the tenant's request, at any time during the lease, the landlord must show the tenant written proof of the interest accrued to the tenant.

After termination of the lease, the landlord may apply the deposit and interest towards the payment of all amounts for which the tenant is liable under the lease, including the reasonable costs of repairing damage to the dwelling, and the costs of replacing lost keys. The balance must be refunded to the tenant within 14 days of the dwelling being returned to the landlord.

If no amounts are due and owing to the landlord in terms of the lease, the deposit and interest must be refunded to the tenant, without any deduction or set-off, within seven days of the termination of the lease.

- **Inspections**: The tenant and landlord, prior to the tenant moving in, must inspect the dwelling jointly to ascertain any defects or damage. The purpose is to determine and record the landlord's responsibility to fix any defects or damage.

  Within three days of the termination of the lease, the landlord and tenant must arrange a joint inspection, at a mutually convenient time to ascertain if the tenant caused any damage. The failure by the landlord to inspect the dwelling in the presence of the tenant, or to inspect it at all in accordance with the Rental Housing Act,[107] is deemed to be an acknowledgement by the landlord that the dwelling is in a good and proper state of repair.

  Where on termination of the lease the tenant fails to respond to the landlord's request for a joint inspection, the landlord must inspect the dwelling within seven days of termination to determine any damage or loss arising from the tenant's occupancy. Then, after making deductions for repairs and lost keys, the landlord must refund the balance of the deposit, if any, to the tenant within 21 days of the expiry of the lease.

8.3 Renewal of lease

After termination of the lease, if the tenant remains in occupation with the tacit or express consent of the landlord, the lease is deemed to have been renewed on the same terms and conditions as the expired lease. One exception, however, is that during the renewed lease at least one month's

written notice must be given of the intention by either party to terminate the lease.

8.4 Rental Housing Tribunal

Each province is able to establish a Rental Housing Tribunal with jurisdiction for that province. Any tenant or group of tenants, or landlord or group of landlords, or interest group, may lodge a complaint concerning an ‘unfair practice’. Unfair practices include changing of locks; refusal to return deposit; damage to property; demolitions and conversions; eviction; forced entry and obstruction of entry; house rules; intimidation; issuing of receipts; tenants' committees; municipal services; nuisances; overcrowding and health matters; tenant activities; and maintenance and reconstruction or refurbishment work.

The Tribunal will conduct a preliminary investigation, and appoint a mediator if it appears that mediation would resolve the complaint. Where the mediator issues a certificate stating that the dispute remains unresolved, a hearing is conducted by the Tribunal, which makes a ruling it considers to be fair and just in the circumstances. The Tribunal has the power to summon any person to provide any information and may require any document, book, or object as evidence. The Tribunal may make a ruling to terminate any ‘unfair practice’, including a ruling to discontinue overcrowding, unacceptable living conditions, exploitative rentals or lack of maintenance.

A ruling may also determine the amount of rental payable by a tenant. This must be just and equitable to both tenant and landlord and take into account prevailing economic conditions of supply and demand, and the need for a realistic return on investment for investors in rental housing.

For three months from either the date the complaint was lodged, or until the Tribunal has made a ruling, whichever is earlier, the following must apply:

- The landlord may not evict the tenant, unless it is for failure to pay the same amount of rent that was payable before the complaint. If an escalation was implemented before the date of the complaint, then the tenant must pay the increased rental.
- The tenant must continue to pay the same amount of rent payable before lodging the complaint.

- The landlord must continue to effect necessary maintenance.

If the Rental Housing Tribunal has not determined the dispute within three months of the lodging of the complaint, the landlord may institute proceedings in a court of law to evict the tenant.[108]

9 The Consumer Protection Act

The Consumer Protection Act[109] will apply to certain transactions only. Landlords who let premises as part of their business, and rental agents, are seen as ‘suppliers’, and tenants are seen as ‘consumers’ under the Consumer Protection Act.[110] However, a landlord who lets premises in a single private transaction is not seen as a supplier, and will not fall under the Act. Also, the Act will not apply to a lease agreement where the consumer is a juristic person with an asset value or turnover of R3 million or more.

The landlord may be jointly and severally liable with a rental agent for any failure to comply with the Act during the period before the lease is signed. Landlords need to ensure that tenants fully understand the terms and conditions of the lease agreement. The landlord will have the onus of proving that the tenant was not induced to sign.

Tenants must be told of any term that limits the landlord's risk, or where the tenant assumes a risk, or provides an indemnity or an acknowledgment of fact. Some terms are not allowed, such as exempting the landlord from liability for any loss or negligence of the landlord.

Additional protections apply to transactions that fall under the Act where either the tenant or the landlord is a natural person:

- Fixed-term leases are limited to a maximum of two years, unless the landlord can show a demonstrable financial benefit to the consumer for a longer period.
- A tenant may give 20 business days' written notice of cancellation for any reason, no matter what period is required in any lease, even if the lease is in writing. A cancellation fee may apply regarding the unexpired portion of the lease.
- A landlord can only cancel a fixed-term lease within the currency of that agreement if the tenant is in material breach. Twenty business days' written notice must be given, and cancellation is not allowed if the tenant remedies the breach within the 20-day period.
- A landlord must provide notice of termination to the tenant when the lease is ending, even if the period is set out clearly in the lease

agreement. The notice must provide information about any material changes to the renewed lease, and any options open to the tenant.

If a compliance notice issued in terms of the Act to correct prohibited conduct is not complied with, a court may order a fine or imprisonment of up to one year, or both. Fines can be up to ten per cent of annual turnover, or R1 million, whichever is the most. A court may also declare the entire lease void.[111]

The Consumer Protection Act[112] is covered in chapter 30 in this text, as well as in the chapters on contract, sale, credit agreements and web-based chapter on delict.

10 The Land Reform (Labour Tenants) Act[113]

The Act provides security of occupation to labour tenants residing on farms. In some cases they can even acquire ownership and other rights in the land being occupied.

A labour tenant is defined as a person who lives on a farm who provides labour to the owner or lessee in exchange for the right to use cropping or grazing land. The labour tenant must have had a parent or grandparent who lived on the farm in exchange for the same rights to use the land. The definition excludes a farmworker, who is generally paid in cash and not in the right to occupy and use the land.

Deo Volente Rusoord BK v Shongwe and others[114]

The landowner applied for the eviction of people from a farm. The defendants claimed that they qualified for protection against eviction, since they had previously worked on the farm during afternoons, when the previous owner paid them as children either 50c or R1 per day.

The court held that the labour they had provided had merely been a way of earning pocket money. It had not been labour provided in return for the right to reside, graze and crop on the farm.

The Land Claims Court will only make an order of eviction if the labour tenant has refused to provide labour in terms of the agreement. The court will not grant an order if the labour tenant is older than 60 years of age or is unable to provide labour due to disability. The court must be convinced that not relocating the labour tenant would be of greater harm to the owner than the relocation would be to the labour tenant. The owner must pay compensation to the labour tenant, and if the land is not used within 12 months of the relocation, the labour tenant may apply to the court for reinstatement of the right to use and occupy the land.

11 The Extension of Security of Tenure Act[115]

The Act protects the rights of occupancy of people who live on rural land. An ‘occupier’ in terms of the Act excludes a labour tenant, anyone who uses the land for any commercial purpose, and anyone with an annual income of more than R5 000.[116] An occupier is entitled to security of tenure; receipt of post; family life in accordance with that family's culture; burial in accordance with religious or cultural practices, provided the owner previously gave permission for such burials;[117] access to water, and educational and health services.

An occupier may not intentionally harm any other person occupying the land, or cause damage to the property, threaten or intimidate other lawful occupiers, or assist any unauthorised persons to establish new dwellings on the land.

The right of residence will not be terminated where the occupier is over the age of 60 years, or is unable to work due to disability, unless the occupier has committed a serious breach justifying the eviction order being granted. The mere refusal or failure to provide labour will not be a breach sufficient for these purposes.

12 The Prevention of Illegal Eviction from and Unlawful Occupation of Land Act[118]

Under the common law, to evict someone all that the owner had to prove was that he or she was the owner of the property and that the property was occupied by someone else.[119]

The Act was legislated to give effect to the Constitution[120] which provides that everyone has the right to have access to adequate housing, and that no one may be evicted from their home, or have their home demolished, without an order of court made after considering all the relevant circumstances. No legislation may permit arbitrary evictions.

An 'unlawful occupier' is a person who occupies land without the consent of the owner or person in charge. Unlawful occupiers may only be evicted with a court order.[121] If the unlawful occupier is still in occupation after 14 days, the court may grant an order for eviction if it is just and equitable to do so, and after considering all the relevant circumstances, including the rights and needs of the elderly, children, disabled persons and households headed by women.[122]

If no valid defence is provided for the illegal occupation, the court must grant an order of eviction.[123] The eviction order may also include an order for the demolition and removal of the buildings or structures that were occupied by the unlawful occupier.[124] It is the obligation of the State to enforce court orders once granted.

***President of the Republic of South Africa and another v Modderklip Boerdery (Pty) Ltd (Agri SA and others, Amici Curiae)*[125]**

A farm was illegally invaded by 40 000 squatters. The farmer obtained a court order for their eviction, but neither the police, nor any other organs of State, was prepared to assist him in enforcing the eviction order.

The court held that it is the duty of the State to uphold the rule of law and to provide the necessary mechanisms to enforce court orders and other rules to ensure peace and order. The police, and therefore the State, had failed to provide the farmer with an effective mechanism to give effect to the eviction order against the squatters. The State

was ordered to pay compensation to the farmer in respect of the land occupied by the squatters.

PRACTICALLY SPEAKING

Tips for landlords to make the lease work[126]

- **Screen tenants**: Do not rent to anyone before checking their credit history, references, and background. Haphazard screening and tenant selection can result in problems: a tenant who pays the rent late or not at all, ruins the property, or lets undesirable friends move in.
- **Get it in writing**: Ensure all the important terms of the tenancy are in writing. Beginning with the rental application and lease or rental agreement, be sure to document important facts of the relationship, including when and how you handle tenant complaints and repair problems, and the notice you must give to enter the property.
- **Handle security deposits properly**: Establish a fair system of setting, collecting, holding, and returning security deposits.
- **Inspect the property**: Use a digital camera to take photographs with the tenant of the exterior, walls, carpet and floor, kitchen cabinets, light fittings and any items that might be damaged or removed.
- **Make repairs**: Stay on top of maintenance and repair needs and make repairs when requested. If the property is not kept in good repair, you will alienate good tenants, and tenants may gain the right to withhold rent, repair the problem and deduct the cost from the rent, or sue for injuries caused by defective conditions.
- **Obtain insurance**: Purchase enough liability and other property insurance. A well-designed insurance programme can protect you from legal action by tenants for injuries or discrimination and from losses to your rental property caused by everything from fire and storms to burglary and vandalism.
- **Resolve disputes**: Try to resolve disputes with your tenants without lawyers and lawsuits. If you have a conflict with a tenant over rent, repairs, your access to the rental unit, noise, or some other issue that does not immediately warrant an eviction, meet with the tenant to see if the problem can be resolved informally. If that does not work, consider mediation by a neutral third party.
- **Small claims court**: If the landlord is a natural person and your dispute involves money, and all attempts to reach agreement fail, try the small claims court where you can represent yourself. The small claims court is good for collecting unpaid rent or seeking money for property damage after a tenant moves out and the security deposit is exhausted.

THIS CHAPTER IN ESSENCE

1 A lease is a contract between two persons for the letting by the landlord and the hiring by the tenant of specified immovable property, in terms of which the landlord grants the temporary use and occupation of the property to the tenant for a period in time in return for a specific sum of money (or a share in the proceeds or fruits of the property) called rent.
2 The parties do not intend the tenant to have the use of the property permanently, but only for a fixed period.
3 The common-law duties of the landlord are to deliver the use and occupation of the leased property at the time agreed upon; maintain the property; and to protect the tenant against interference in the use of the property.
4 Common-law duties of the tenant are to pay the rent; ensure that the property is not misused and is used only for purpose for which it was let; and to return the property undamaged at the end of the lease.
5 *Huur gaat voor koop* applies to situations where a new landlord takes ownership of the leased premises.
6 The 1658 *Placaat of the Estates of Holland* allows a tenant to remove useful improvements made to the premises with the landlord's consent, or claim compensation for them, in respect of leases over rural property.
7 In terms of the Rental Housing Act, a landlord may give notice to a tenant of the landlord's intention to cancel the contract if the rent is not paid within a reasonable time. After this notice has been given, the tenant's failure to pay the rent due will entitle the landlord to cancel the contract.
8 The landlord has a real right of security called a tacit hypothec over any movables on the leased premises.
9 If the Consumer Protection Act applies to a lease agreement, a tenant may give 20 business days' written notice of cancellation for any reason, no matter what period is required in any lease, even if the lease is in writing. A cancellation fee may apply to the unexpired portion of the lease.

10 The Land Reform (Labour Tenants) Act provides security of occupation to labour tenants residing on farms.
11 The Extension of Security of Tenure Act protects the rights of occupancy of people who live on rural land.

QUESTIONS

Short questions (1–5 marks)

1. Define lease.
2. What are the three essential elements in any contract of lease?
3. List two ways in which a lease can be renewed.
4. What is a *bywoner*?
5. What three remedies are available to a tenant where the landlord fails to keep the premises in a fit state of repair?

Paragraph questions (5 marks)

1. What formalities are required for a valid lease?
2. Discuss the landlord's common-law duties.
3. Discuss the impact of the 1658 *Placaat of the Estates of Holland*.
4. Discuss the meaning and the effect of the maxim *huur gaat voor koop*.
5. Discuss the procedure by which an unlawful occupier may be evicted in terms of the Prevention of Illegal Eviction from and Unlawful Occupation of Land Act.
6. Discuss the rights of parties under the Rental Housing Act.

Essay questions (10 marks)

1. Discuss the remedies available to the landlord where the tenant is in breach of the lease.
2. Discuss issues relating to the failure to pay the rent on time.
3. Discuss what is meant by the warranty against interference in a contract of letting and hiring of immovable property.
4. Write notes on the landlord's tacit hypothec.

Problem questions (20 marks)

1. Frank wants to open a restaurant in Gary's shopping centre and enters into a lease with Gary on 1 January. The monthly rental is R2 000 and the lease is to extend until 31 December. The restaurant is very popular and Frank makes a monthly net profit of R25 000. On 30 June, Gary sells the shopping centre to Harriet. Harriet then gives Frank notice that his lease has lapsed as a result of the centre having been sold. Discuss the legal positions of the parties.
2. Morris lets a flat to Norman for a year at a monthly rental of R1 500. In terms of the agreement, Morris agrees to paint the premises before Norman takes occupation. Consider the following situations:
    a. Norman is given the keys to the flat. When he arrives to take occupation he finds that someone else is in occupation and that the flat has not been painted. Norman does not wish to cancel the contract. Advise him of his rights.
    b. During the lease Norman throws a wild party. A fight breaks out and one of the guests kicks in a door. When Norman vacates the premises at the end of the lease, the door is damaged. Advise Morris of his remedies.
    c. During the lease a structural defect manifests itself, which interferes with Norman's use and enjoyment of the premises. The defect also causes damage to his expensive sound system. Norman wants to cancel the lease and claim damages.
    d. Norman discovers that the tenant in the flat next door is apparently a drug dealer and there are many strange looking people visiting at all hours.
    e. Another one of Norman's neighbours, three flats down the passage, is a religious fundamentalist, and objects to Norman being homosexual. Norman came home one day to find the door of his flat has been painted with obscene messages in red paint.
3. Harry rented his house to André for a period of two years, as of 1 May 1994. After André had moved in, Harry sold the house to Mary. On 1 November 1994 the property was transferred to Mary's name and Mary immediately gave André notice that he

had to vacate the property, since she and her family wished to move into the house within the next month. André refused to move out, arguing that the maxim *huur gaat voor koop* was applicable to the situation and that he therefore had a right to remain in the house until the two-year lease had expired. Mary then asked Harry to evict André. Explain the meaning of the maxim *huur gaat voor koop*, why it applies to this situation, and how it functions to protect André.

4. Sipho is 14 years old. After his parents died of Aids, he lives alone in a shack on a piece of land near a road. He survives by begging. He comes to your office with a letter, and asks you to read it for him. The letter is from a man who writes that Sipho is in illegal occupation of the land, and must demolish his shack and leave because the land is going to become part of a national game reserve. Advise Sipho of his rights.
5. Mavis lives with 13 other people in a room in the city. The water does not run, the lifts don't work, and the toilet has been blocked for months. The rent is R3 000 a month. As none of the people in the room are South African citizens, the landlord has threatened to report them all to the police if they do not pay. Now he is asking for more rent. She comes to your office. Advise her of her rights.

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1 *Kessler v Krogmann* 1908 TS 290; *De Jager v Sisana* 1930 AD 71; Gibson, 180–181; Havenga et al., 135; Sharrock, 261.

2 Gibson, 182.

3 *Total South Africa (Pty) Ltd v Xypteras* 1970 (1) SA 592 (T) at 596.

4 *Van der Westhuizen v Glastonbury* 1908 TS 836.

5 *Edwards Gold Mining Company Ltd v Mamagale NO and Bakwena Mines Lines Ltd* 1927 TPD 288; *Bozzone and others v Secretary for Inland Revenue* 1975 (4) SA 579 (A).

6 *Bozzone and others v Secretary for Inland Revenue* 1975 (4) SA 579 (A).

7 Sharrock, 264–266.

8 *Dick v Hiddingh* (1830) 1 Menz 499.

9 Consumer Protection Act 68 of 2008.

10 *Cohen v Van der Westhuizen* 1912 AD 519 at 529; *De Kock v De Kock* 1966 (1) SA 37 (E).

11 *Fulton v Nunn* 1904 TS 124.

12 *Friedman v Friedman* 1917 CPD 268.

13 Consumer Protection Act 68 of 2008.

14 *OK Bazaars (1929) Ltd v Cash-In CC* 1994 (2) SA 347 (A); Sharrock, 265–266.

15 *Pareto Ltd and others v Mythos Leather Manufacturing (Pty) Ltd* 2000 (2) SA 999 (W); Sharrock, 266.

16 *Bowhay v Ward* 1903 TS 772.

17 *Pareto Ltd and others v Mythos Leather Manufacturing (Pty) Ltd* 2000 (2) SA 999 (W).

18 *Doll House Refreshments (Pty) Ltd v O'Shay* 1957 (1) SA 345 (T).

19 Rental Housing Act 50 of 1999.

20 Consumer Protection Act 68 of 2008.

21 *Jordaan NO and another v Verwey* 2002 (1) SA 643 (E).

22 *Crous v Crous* 1937 CPD 250 at 257; *Trook t/a Trook's Tea Room v Shaik and another* 1983 (3) SA 935 (N).

23 *Birkenruth Estates (Pty) Ltd v Unitrans Motors (Pty) Ltd (formerly Malbak Consumer Products (Pty) Ltd) and others* 2005 (3) SA 54 (W).

24 *Trook t/a Trook's Tea Room v Shaik and another* 1983 (3) SA 935 (N).

25 *Black v Scheepers* 1972 (1) SA 268 (E); *Kriel v Hochstetter House (Edms) Bpk* 1988 (1) SA 220 (T).

26 *Uitenhage Divisional Council v Port Elizabeth Municipality* 1944 EDL 1 at 10; *Nelson v Botha* 1960 (1) SA 39 (O).

27 *Southernport Developments (Pty) Ltd v Transnet Ltd* 2005 (2) SA 202 (SCA).

28 Gibson, 182.

29 Rental Housing Act 50 of 1999.

30 Ibid.

31 Gibson, 183–185; Havenga et al., 135–136; Sharrock, 271–278.

32 *McNeill v Eaton* (1903) 20 SC 507; *Pistorius v Abrahamson* 1904 TS 643.

33 *McNeill v Eaton* (1903) 20 SC 507; *Pistorius v Abrahamson* 1904 TS 643; *Tsandu v City Council Johannesburg* 1947 (1) SA 494 (W).

34 *De Beers Consolidated Mines v London and South African Exploration Company* (1893) 10 SC 359; *Poynton v Cran* 1910 AD 205; *Harlin Properties (Pty) Ltd v Los Angeles Hotel (Pty) Ltd* 1962 (3) SA 143 (A); *The Treasure Chest v Tambuti Enterprises (Pty) Ltd* 1975 (2) SA 738 (A); *Heerman's Supermarket (Pty) Ltd v Mona Road Investments (Pty) Ltd* 1975 (4) SA 391 (D).

35 *Harlin Properties (Pty) Ltd v Los Angeles Hotel (Pty) Ltd* 1962 (3) SA 143 (A).

36 *Poynton v Cran* 1910 AD 205.

37 *Harlin Properties (Pty) Ltd v Los Angeles Hotel (Pty) Ltd* 1962 (3) SA 143 (A).

38 *The Treasure Chest v Tambuti Enterprises (Pty) Ltd* 1975 (2) SA 738 (A).

39 *Hunter v Cumnor Investments* 1952 (1) SA 735 (C).

40 *Shapiro v Yutar* 1930 CPD 92; *Steynberg v Kruger* 1981 (3) SA 473 (O).

41 *Frenkel and Co v Rand Mines Produce Supply Co* 1909 TS 129.

42 *Fourie NO en 'n ander v Potgietersrus Stadsraad* 1987 (2) SA 921 (A); Sharrock, 272–273.

43 *Fourie NO en 'n ander v Potgietersrus Stadsraad* 1987 (2) SA 921 (A).

44 *Baum v Rode* 1905 TS 66; *Mackay v Theron* 1947 (1) SA 42 (N).

45 *Soffiantini v Mould* 1956 (4) SA 150 (E).

46 *Daly v Chisholm and Co Ltd* 1916 CPD 562; *Bayley v Harwood* 1954 (3) SA 498 (A).

47 Sharrock, 274.

48 Gibson, 180–182; Havenga et al., 136–138; Sharrock, 278–280.

49 *Steynberg v Kruger* 1981 (3) SA 473 (O).

50 *Pillay v Krishna* 1946 AD 946.

51 Sharrock, 278–279.

52 *Van Loggenberg v Sachs* 1940 WLD 253.

53 *Davis v Pretorius* 1909 TS 868; *National Bank of South Africa Ltd v Leon Levson Studios Ltd* 1913 AD 213.

54 *Matador Buildings (Pty) Ltd v Herman* 1971 (2) SA 21 (C).

55 *Venter v Venter* 1949 (1) SA 768 (A).

56 Ibid.

57 *Garlick Ltd v Phillips* 1949 (1) SA 121 (A); *Myerson v Osmond Ltd* 1950 (1) SA 714 (A).

58 *Goldberg v Buytendag Boerdery Beleggings (Edms) Bpk* 1980 (4) SA 775 (A).

59 Rental Housing Act 50 of 1999.

60 *Bayley v Harwood* 1954 (3) SA 498 (A).

61 Ibid.

62 *GA Fichardt Ltd v Leviseur* 1915 AD 182; *Temple v Schroer* 1929 SWA 14; *Burns v D and G (Pty) Ltd* 1949 (4) SA 135 (T); *Weinberg v Weinberg Bros (Pty) Ltd* 1951 (3) SA 266 (C) at 272; *Moosa v Samugh* 1952 (1) SA 29 (N); *Bayley v Harwood* 1954 (3) SA 498 (A).

63 *Lomax v Killarney of Durban (Pty) Ltd* 1961 (2) SA 573 (D).

64 Ibid.

65 *Oatarian Properties (Pty) Ltd v Maroun* 1973 (3) 21 779 (A).

66 *United Whalers Ltd v Union Government* 1953 (3) SA 900 (C).

67 Sharrock, 280.

68 *Neebe v Registrar of Mining Rights* 1902 TS 65; *Henning v Le Roux* 1929 CPD 587; *Sarkin v Koren* 1949 (3) SA 545 (C).

69 *Barker v Beckett and Co Ltd* 1911 TPD 151; *Salmon v Dedlow* 1912 TPD 971.

70 *Salmon v Dedlow* 1912 TPD 971.

71 *North Western Hotel Ltd v Rolfes, Nebel and Co* 1902 TS 324.

72 *Marcuse v Cash Wholesalers (Pvt) Ltd* 1962 (1) SA 705 (FC); *Bourbon-Leftley v Turner* 1963 (2) SA 104 (C).

73 *Manley van Niekerk (Pty) Ltd v Assegai Safaris and Film Productions (Pty) Ltd* 1977 (2) SA 416 (A); *Isep Structural Engineering and Plating (Pty) Ltd v Inland Exploration Company (Pty) Ltd* 1981 (4) SA 1 (A).

74 Gibson, 186–194.

75 *Soffiantini v Mould* 1956 (4) SA 150 (E).

76 *De Wet v Union Government* 1934 AD 59; *Boshoff v Theron* 1940 TPD 299; *Shalala and another v Gelb* 1950 (1) SA 851 (C); *Kessoopersadh v Essop* 1970 (1) SA 265 (A); Gibson, 196; Havenga et al., 138; Sharrock, 267–268.

77 *Mignoel Properties (Pty) Ltd v Kneebone* 1989 (4) SA 1042 (A).

78 *Stellenbosch Divisional Council v Shapiro* 1953 (3) SA 418 (C).

79 Sharrock, 267.

80 Sharrock, 268.

81 *De Beers Consolidated Mines v London and South African Exploration Company* (1893) 10 SC 359; *Oosthuizen v Estate Oosthuizen* 1903 TS 688; *Van Wezel v Wezel's Trustee* 1924 AD 409; *Lechoana v Cloete* 1925 AD 536; *Nogama v Holtshauzen* 1985 (2) SA 581 (W).

82 Articles 10, 11, 12 and 13 of the *Placaat of the Estates of Holland* of 1658.

83 Gibson, 197–199.

84 *Burrows v McEvoy* 1021 CPD 229.

85 *De Beers Consolidated Mines v London and South African Exploration Company* (1893) 10 SC 359; *Oosthuizen v Estate Oosthuizen* 1903 TS 688; *Steyn v Fourie* 1956 (4) SA 458 (A).

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Chapter 19

Insurance

'Insurance: An ingenious modern game of chance in which the player is permitted to enjoy the comfortable conviction that he is beating the man who keeps the table.'

AMBROSE BIERCE (1842–1913)
AMERICAN SATIRIST

What is covered in this chapter

1 Definition of insurance
2 Types of insurance contracts
3 Formalities
4 Essential elements
5 Insurable interest
6 Concepts in insurance law
7 Good faith: the duty of disclosure
8 Special terms in insurance contracts
9 Subrogation
10 Legislation
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

No one wants to die and no one wants to have a car stolen or property destroyed by fire; but it certainly makes things easier if you are insured and get paid out if any of those bad things happen! It is useful to understand what one can legally take out an insurance policy for, and what the rights and duties of the insurance company are as well as the person who is insured.

In business, taking out insurance is a way of reducing risk, and so it is vital that we understand special terms that may apply in insurance contracts. In particular, we need to understand that insurance companies work out the premiums that must be paid to them based on the amount of the risk they foresee; this means that people who want insurance have a duty to tell the insurer anything that could affect the insurance company's view of the nature and extent of the risk. This is known as the duty to make disclosure in good faith.

Lastly, we need to understand that insurance companies can take legal action to get back the money they pay out to the people they have insured. They do this by suing those people who caused the damage or loss to their insured clients. What surprises many people is that they can use the name of their insured client to take legal action, without telling the insured client that they are doing so. This is the effect of ‘subrogation’.

1 Definition of insurance

An insurance contract is between an insurer and an insured, by which the insurer undertakes, in return for the payment of a price (premium), to give the insured a sum of money or its equivalent, on the occurrence of a specified uncertain event in which the insured has some interest.[1]

The contract comes into existence on the agreement of the following four essential terms:

- The identity of what is being insured.
- The risks insured against.
- The amount of the premium payable.
- The time period for which cover extends.[2]

2 Types of insurance contracts

South African law recognises two types of insurance contracts:[3]

- **Indemnity insurance**: The insurer undertakes to compensate the insured for an actual loss he or she may suffer in future. The event may never occur, and the amount the insurer will pay is uncertain at the time the policy is issued, for example for fire or theft insurance. The event must happen first before the insurer can quantify the amount of the loss suffered.
- **Non-indemnity insurance**: The insurer undertakes to pay an agreed specified amount on the occurrence of a certain event. The amount payable is not related to the extent of loss suffered. The amount is determined at the time the policy is issued, for example for life insurance.

3 Formalities

The regular law of contract applies. The general principle is that no formalities are required.

4 Essential elements

There are four essential elements in any contract of insurance:[4]

- **Obligation of the insurer to pay a sum of money or its equivalent**.

> ***Department of Trade and Industry v St Christopher Motorists Association Ltd*** [5]
>
> A motorists' association arranged a system by which, in return for an annual amount paid by each member, the association would provide a chauffeur if a member's driving licence were removed as a result of any drunken-driving conviction.
>
> The court held that the association was in fact carrying on the business of an insurance company and so had to comply with the relevant insurance legislation.[6]

- **Obligation of the insured to pay a premium**.[7]
- **The occurrence of an uncertain future event**: The requirement of uncertainty means that the occurrence of the event must be beyond the control of the insurer.[8]
- The uncertainty can relate to one of two aspects of the event:
  - It may be uncertain whether the event will happen at all. For example, a motor vehicle collision.
  - It may be certain that the event will occur, but the moment of occurrence is uncertain. For example, death.
- **An insurable interest**: In Roman-Dutch law, all gambling and wagering agreements are unenforceable. As a result, the practice of using insurance contracts to gain enforceability developed.[9]

5 Insurable interest

In 1774, the English Parliament enacted the Life Assurance Act,[10] which outlawed gambling agreements in insurance policies in which the insured had no insurable interest in the subject matter insured. For example, insuring the lives of strangers and then collecting the insurance when they died.

If a person can show that he or she stands to lose something of an appreciable commercial value by the destruction of the thing insured, he or she has an 'insurable interest' in the thing insured even when he or she does not necessarily have a personal or real right in the thing. The test of whether one can show loss is therefore a factual one.[11]

5.1 Insurable interest for indemnity insurance

The insured must prove an insurable interest existed at the time the event occurred in order to prove loss.

There are four classes of insurable interest:

- **Real rights**: Any of the following indicates an insurable interest and may be validly insured:
  - The owner of a thing with a real interest in its preservation.[12]
  - The legal possessor. For example, someone who has loaned or hired property such as a motor vehicle.
  - A consumer in terms of an instalment credit agreement.
  - The holder of contingent interests. For example, a custodian, representative, or spouse.

Littlejohn v Norwich Union Fire Insurance Society [13]

A man had taken out fire insurance in his own name over the contents of a shop owned by his wife, to whom he was married out of community of property.

The court held that since he would be in a worse position after his wife's property was burnt, he did have an insurable interest.

Phillips v General Accident Insurance Co (SA) Ltd [14]

The court held that a husband had an insurable interest in his wife's jewellery, even though he was under no obligation to replace it.

A shareholder will generally have no insurable interest in the property belonging to a company, even if he or she is the sole shareholder. However, proof of an indirect economic interest might prove sufficient to found an insurable interest.[15] Whether or not an indirect economic interest will be sufficient to found an insurable interest will depend on the facts of each case.

Lynco Plant Hire and Sales CC v Univem Insurance Brokers CC [16]

A CC had leased two motor vehicles. In terms of the credit agreement, it had accepted the risk of loss or damage to the vehicles. The defendant had advised taking out insurance in the name of one of the members who had a 30% interest in the CC. An agreement was then made between the CC and the member in terms of which he agreed to pay the CC any payments that might be received by him under the policy. Both vehicles were stolen, and the insurance company refused to indemnify the member on the basis that he had no insurable interest in the insured vehicles.

The court had to decide whether, in order for there to be an insurable interest, the insured must have a direct interest in the subject matter of insurance in the form of a real right or a personal right, or whether an indirect interest such as an economic interest would be sufficient. The court held that while the CC had a direct interest in the two motor vehicles, the member had an indirect economic interest by virtue of his shareholding in the close corporation and by virtue of the fact that he had a contractual obligation to repay the CC any monies paid out in terms of the contract of insurance.

In the circumstances the court held that the member did have an insurable interest in the two insured vehicles.

- **Personal or contractual rights**: An unsecured creditor has no insurable interest in the estate of the debtor.
- **Legal liability**: A person facing the prospect of future legal liability may take out insurance.
- **Factual expectation of damage**: The contract may be enforceable, provided it does not amount to a wager. The existence of an insurable interest serves as an indication of the intention to enter into an insurance contract.[17]

Fir and Ash Investments (Pty) Ltd v Cronje and others[18]

Leased premises were damaged by fire allegedly caused by the negligence of the tenant's employees. The landlord's insurer then brought an action by subrogation to

recover damages from the tenant. The tenant raised the defence that since the lease obliged the landlord to insure the premises, the insurance would be to the benefit of both landlord and tenant.

The court held that the insurance taken out by the landlord did not imply that the insurance was to be for the joint benefit of landlord and tenant. Since the lease obliged the tenant to repair or replace the property leased if it was damaged or destroyed, the tenant had an insurable interest and therefore should have taken out his own policy of insurance.

5.2 Insurable interest for non-indemnity insurance

The insurable interest must exist at the time of the issue of the policy. A value must be placed on the insurable interest. The court works with a presumption of insurable interest, and a presumption that the insurable interest is unlimited.

- A person has an insurable interest in the life of his or her spouse. This interest is unlimited.
- A creditor has an insurable interest in the life of a debtor. The interest is limited to the amount of debt at the time the policy is issued.
- Partners have insurable interests in the life of the partnership.[19]

6 Concepts in insurance law

6.1 The proponent

The party who applies for insurance cover is called the ‘proposer’ (or proponent). He or she fills out a proposal form, at the end of which is a clause called a ‘declaration’. The declaration states that the answers to the questions on the proposal form are declared to be the basis of the policy. The completed proposal form amounts to an offer by the proposer to be insured on the usual terms of the insurer.

6.2 The insurer

The insurer may accept the offer by issuing a policy. There is controversy as to whether the issue of a temporary cover note amounts to the final acceptance of the insurance proposal, or if it is intended to last only until the insurance company has made up its mind whether to grant the actual policy.

6.3 The policy

The policy together with the proposal form (generally incorporated by reference) forms the complete contract of insurance.

6.4 Limitations on policy benefits: the unborn and certain minors

The Long-Term Insurance Act[20] and the Short-Term Insurance Act[21] impose limitations on the benefits of a life insurance policy in the event of the death of an unborn or certain minors. These limitations are generally as follows:

- Death of an unborn or a minor aged up to and including six years: R10 000 maximum.
- Death of a minor aged over six years and up to and including 14 years: R30 000 maximum.

6.5 The Consumer Protection Act

An insurance contract may be a type of transaction covered under the Consumer Protection Act.[22] This act is dealt with in greater detail in chapter 30 in this text.

7 Good faith: the duty of disclosure

7.1 The proposal form

Insurance companies occasionally deal with insured parties who fail to tell the company all it needs to know about the risk. Sometimes this is because they simply do not reveal all material facts to the insurer, and sometimes it is because they intentionally misrepresent their situation. An important distinction can be drawn between misrepresentation by omission and misrepresentation by commission.

Insurers are forced to work on information supplied by proposers. To protect the insurer, the law creates a duty of disclosure on the insured. The insured is required to answer questions put to him or her in the proposal form both truthfully and accurately, and is obliged to volunteer knowledge material to the risk.[23]

***Lambert v Co-operative Insurance Society Ltd*[24]**

A spouse signed a proposal form for the insurer to cover both her own and her husband's jewellery. The policy was renewed annually. She did not volunteer information regarding her husband's criminal conviction a few years previously for receipt of stolen goods. The husband was convicted subsequently of two crimes involving dishonesty, none of which she reported to the insurance company.

The court found that she had failed to disclose information material to the risk.

The traditional basis for the duty of disclosure is that insurance is a contract of ‘utmost good faith’ or *uberrima fides*.[25]

***Mutual and Federal Insurance Company Ltd v Oudtshoorn Municipality* [26]**

The court dealt with a case involving ‘misrepresentation by omission’, that is, the non-disclosure of material facts. The municipality operated an airfield. A warning beacon on a high mast was not working and the municipality failed to inform the insurance company of this. After an aircraft crashed, the insurance company repudiated the claim because of the failure of the municipality to inform them of the beacon.

The majority of the court expressly rejected the traditional view that a contract of insurance is one of utmost good faith. They held that all contracts require good faith; there are no degrees of good faith. The duty of disclosure arises by operation of law. Where one party has access to knowledge not accessible to the other, and where by the nature of the contract the latter party binds himself or herself on the basis that all

material facts have been disclosed, the non-disclosure of that material fact renders the contract void. This is because the risk run by the insurer is in fact different from the risk it intended to run at the time of the conclusion of the agreement.[27] A 'material fact' relating to disclosure is one that affects the decision to issue the insurance policy, or affects the decision about what premium will be charged.[28]

The court applied the 'reasonable person' test in assessing materiality of facts relating to disclosure. When considering the facts in each case, the question is whether an undisclosed fact is reasonably relative to the risk or the assessment of the premiums. The court decided this objectively from the point of view of the reasonable person.[29]

In a later case, the court amended the common-law position by assessing the materiality of facts subjectively from the point of view of the particular insurer.

Qilingele v SA Mutual Life Assurance Society [30]

The court was faced with a 'misrepresentation by commission', that is, where a false statement was made.

The case involved an applicant for life insurance, who did not want to undergo a medical examination. To avoid this, he applied for three separate life insurance policies with three insurance companies for small amounts that, when added together, would have otherwise required him to undergo a medical examination. When asked in the proposal form whether any other insurance company was considering offering him life cover he falsely answered, 'No'. He also signed a warranty that he had not made any other application to any other insurer.

The court applied the 'particular insurer' test in assessing materiality of facts relating to disclosure. It did so by considering whether the falsehood of the misrepresentation probably would have affected the assessment of the risk undertaken by the particular insurer. This was done by comparing an assessment of the risk on the basis of facts as distorted by the misrepresentation with what the assessment would have been on the facts if they had been truly stated. The disparity would be significant if the insurer, had it known the truth, probably would have refused to undertake the particular risk, or probably would only have undertaken the risk on different terms. The court decided this subjectively from the point of view of the particular insurer.

The *Qilingele* case[31] caused some confusion regarding the test for materiality of risk. The Long-Term Insurance Act[32] and the Short-Term Insurance Act[33] have both been amended to ensure that the test for materiality is restored to the position adopted in the *Oudtshoorn Municipality* case. Currently the test for materiality is whether the reasonable person (as opposed to the reasonable insured or reasonable insurer) would consider that the particular information should have been disclosed to the insurer so that the insurer could form its own view as to its

effect. The test for materiality is objective. The general rule is that an insurer is entitled to be accurately informed about all facts known to the insured that are material to the risk, whether or not a proposal form is completed. Misrepresentation by commission or by omission amounts to a breach of the insured's general duty to make disclosure.

A ‘warranty’ is a statement upon the exact truth of which, or the performance of which, the validity of the contract depends. Under the common law, if a warranted statement is false then the insurer is able to escape liability under the contract. However, both the Long-Term Insurance Act[34] and the Short-Term Insurance Act[35] have changed the common-law position, and made it more difficult for insurers to avoid claims on the breach of warranties. In terms of this legislation, the insurer is only able to avoid a claim for breach of warranty if the breach was ‘material to the risk’. In situations involving either misrepresentation by omission, or misrepresentations by commission, the risk is decided objectively according to the standard of the reasonable person.

A fact that is ‘material to the risk’ is every circumstance that a reasonable person might suppose could in any way influence the insurer in considering whether it will enter into the contract at all, and on deciding the terms of the contract, such as the amount of the premium.

Santam Limited v Van Schalkwyk [36]

A man loaned his son the deposit for a motor vehicle. The son lived in Florida and needed the car to travel to work. The father lived in Kroonstad. The father took out an insurance policy and the car was stolen. The insurer repudiated because the father had not disclosed that the vehicle had been bought by the son, was used exclusively by the son, and was kept in Florida and not Kroonstad.

The court held that a proposer for insurance has a legal duty to disclose to his insurer all facts within his knowledge that a reasonable person would consider material to the assessment of the risk or the premium. The information which the insured is obliged to disclose is that information which the reasonable person would view as influencing the insurer's decision as to whether it would accept the risk and, if so, at what premium.[37]

Expert evidence was lead to show that the risk of theft was much greater in Florida than it was in Kroonstad. The court held that the undisclosed information would, in the opinion of the reasonable person, have impacted on Santam's assessment of the relevant risk.

The court further held that the undisclosed information would have been material to Santam as the father would have had no legal rights in respect of the insured vehicle that could have been enforced against a third party, with the result that Santam's right to effect a recovery in terms of the doctrine of subrogation would have been prejudiced.

The court held that in the circumstances the father had failed to disclose material information that entitled the insurance company to avoid the policy.

Examples of information that could affect the decision of the insurer whether or not to enter into the contract of insurance, or to charge a higher premium, could include the following:[38]

- Facts showing that the subject matter is exposed to a higher degree of danger than normal.

Van Zyl and Maritz NNO and others v South Africa Special Risks Insurance Association and others [39]

An insured political activist did not disclose that he had received several threats of personal harm and harm to property.

The court held that the insured had failed to disclose material facts that were relevant to the assessment of the risk.

- Facts showing that the liability of the insurer may be greater than normal.
- Facts showing that the insured may cause the harm to occur through his or her own conduct. For example, the insured's financial history, or claims history with similar insurance policies.

Munns and another v Santam Ltd [40]

The court held that an insured with a poor financial history who was in financial difficulty could submit an inflated insurance claim, or fail to take proper steps to protect the property. These factors affected the insured's whole personality and affected the ‘moral risk’ of an insured.

The failure to disclose these factors were held to be relevant to the assessment of the risk.

- Facts showing that the value of the insurer's rights of subrogation would be reduced.[41]

Commercial Union Insurance Co of SA Ltd v Lotter [42]

The buyer of a luxury motor vehicle discovered that it had been stolen from another country. He then insured the vehicle without disclosing this to the insurer. The vehicle was stolen again, and the insurance company repudiated the claim.

The insurance company argued that the fact the vehicle was a stolen vehicle when the insurance policy was taken out had diminished the insurance company's right of subrogation under the policy. Any third party who was sued for causing

damage to the vehicle could get off by claiming that the insured had no title to the vehicle. Also, the only insurable interest that could be proved was limited to the value of the insured's interest in retaining the vehicle until it was recovered by the true owner. This meant that the insurance company could not sue a negligent third party for the full costs of repairing any damage to the vehicle.

The court held that the undisclosed facts had materially affected the risk, alternatively the assessment of the premiums.

- Facts showing that the insured is in financial difficulty and may have problems paying the premiums.[43]

The duty of disclosure recurs upon each renewal of an indemnity policy. The renewal may be based on the original proposal form as amended by subsequent disclosure. The proposal form is interpreted in the same manner as the policy itself and the same rules of construction apply.

An insured is not obliged to disclose material facts that the insurer knows or ought to know. In the absence of fraud, an insurer who avoids a policy must return the premium received.

The duty of disclosure will arise at different times for indemnity and non-indemnity insurance:

- **Indemnity insurance**: The duty of disclosure recurs on each renewal. A renewal is seen as the original proposal form as amended by subsequent disclosures.
- **Non-indemnity insurance**: The duty of disclosure arises only once, before the contract is originally entered into. The duty does not arise anew on the anniversary of the contract. Punctual payment of renewal premiums is a condition that must be met before the contract may continue.

7.2 The claim form

What is the situation where only a part of the claim is fraudulent? For example, where the claim is inflated – should the entire claim be forfeited, or should the payment be limited to the amount to which the insured is genuinely entitled?[44]

The two sides to this debate are clear: An insurer would argue that given the special nature of a contract of insurance and the vulnerability of insurers to fraud, any fraud should result in the forfeiture of the entire claim. An

insured would say that to deny an insured that which is truly payable and for which a premium has been paid, is to impose a penalty upon the claimant, something our law does not provide for.

Under the Roman-Dutch law, the sanctions for a fraudulent claim were firstly, refusal to allow an insured to profit by the fraud; secondly, making the insured liable for any loss or expenditure caused by the fraudulent conduct; and thirdly, criminal sanctions entailing vigorous punishment. Forfeiture of the entire claim does not appear clearly as one of the available sanctions.

Under English law, even if a policy contained no such specific term providing for forfeiture of the entire claim, it is an implied term of any policy of insurance that an insurer can repudiate an entire claim where it is tainted with fraud. This is based on the English law notion of an insurance contract as being a contract of the utmost good faith.[45]

Our law distinguishes between three different types of fraud in the context of insurance policies:[46]

- **Fabricated claim**: In this situation the insured suffers no actual loss, or no loss covered by the insurance contract. Normally, there is no way that the insured could claim anything from the insurance company. However, the insured lies, or even causes the loss, and then fraudulently represents to the insurer that the loss was caused by an event specified in the insurance contract.
- **Exaggerated claim**: This involves an exaggeration of the loss to enable the insured to claim more from the insurer than would otherwise have been possible. The insured actually does suffer a loss, but claims for a larger amount.
- **Valid claim accompanied by fraudulent means**: This type of fraudulent claim is the least serious form and involves a technical or petty fraud designed to reduce delay in payment. For example, forging a signature on a form to reduce a delay while someone is away on holiday.[47]

The onus of proof rests on the insurer on a balance of probabilities.

Schoeman v Constantia Insurance Company [48]

The insured sent to her insurer a claim form in respect of items that had been burgled from her home. On the claim form an amount of R20 000 was claimed for ‘various items of clothing’. After the insurance company investigated the matter, and after she failed a lie detector test, the insurance company repudiated the claim because it believed that the insured had fraudulently exaggerated her loss by placing a higher value on certain of the missing items than had actually been the case.

In this case there was no express clause in the policy that entitled the insurance company to repudiate the insured's entire claim, if part of the claim was lodged fraudulently.[49]

The court held that there is no authority in Roman-Dutch law for implying a penalty term in a contract, nor is there a compelling social need for the adoption of such a doctrine. The court recognised the policy considerations in favour of adopting the doctrine but held that the cost of doing so would be that cases could arise in which a gross inequity could occur. Furthermore, as insurance companies are in charge of their own policies and can unilaterally devise them to include a forfeiture clause, there does not appear to be any pressing need for the law to provide such protection. The court listed the other sanctions available, including prosecution for fraud; potential inability to obtain insurance cover in the future; punitive costs orders made by the court; delictual liability for expenses incurred in investigation by the insurer; likely problems an insured can experience having his or her evidence regarding the valid parts of the claim accepted and satisfying the court that the tainted aspect of the claim can and should be separated.

The court ordered that the insurance company was liable to indemnify the insured for her loss suffered as a result of the burglary.

The submission of a fraudulent claim will also entitle the insurer to terminate the policy of insurance.

South African Eagle Insurance Co Ltd v KRS Investments CC [50]

An insured submitted a false claim, and the insurer terminated the policy with retrospective effect from the date of the attempted fraud.

The court held that the insurer was not entitled to terminate the policy with retrospective effect. The deliberate submission of a false claim was a breach of the duty of good faith owed by the insured to the insurer. This entitled the insurer to terminate the policy, and the insurer was relieved of liability only from the time of termination. As a result the rights and obligations which had accrued before such termination would remain intact. In the absence of a specific clause in the contract, the insurer had no right to terminate the policy with retrospective effect from the date of the attempted fraud. This would result in the insured forfeiting rights that had accrued before termination, would be punitive, and dispossessed the insured of a perfectly valid claim, untainted by fraud, which accrued contractually before the policy was terminated.

8 Special terms in insurance contracts[51]

8.1 Warranties

A warranty is generally an explicit provision in an insurance contract stating that if it is not adhered to the insurer may avoid the claim.[52]

South African law distinguishes between two types of warranties:

- **Affirmative warranties**: These are statements of fact or current knowledge, for example that the driver is in possession of a valid driver's licence.
- **Promissory warranties**: These are undertakings by the insured pertaining to his or her future conduct during the period of the policy, for example that he or she will not drive while intoxicated.[53]

It has become standard practice for insurers to state that every item on the proposal form was warranted to be true.

> ***Jordan v New Zealand Insurance Company Ltd*** [54]
>
> A proposer for insurance for his motor vehicle stated his age at his next birthday as being 22 years, when in fact it would have been 23 years. The statement was warranted and the insurer was entitled to repudiate liability.

As a result of harsh repudiations based on trivial inaccuracies, particularly in the *Jordan* case, Parliament passed an amendment to the 1943 Insurance Act[55] in force at that time. The effect of this amendment was that an insurer could not set aside a contract on the grounds of breach of an affirmative warranty, unless it could prove that the correctness of the statement, representation, or warranty was material to the assessment of the risk at the time the policy was issued or renewed. The object was to protect claimants against repudiations based on inconsequential inaccuracies or trivial misstatements in insurance proposal forms, even if they were warranted to be true.

The wording of this amendment now finds a place in both the Short-Term Insurance Act[56] and the Long-Term Insurance Act.[57]

As a result, the insurer will be liable if the breach of the affirmative warranty relates to inconsequential inaccuracies. The insurer, however, will not be liable if the breach of the affirmative warranty relates to facts material to the risk. Where there has been failure to comply with an affirmative warranty relating to facts material to the risk, the courts will not allow parties to misrepresent facts and then seek to hold the insurer liable. In these cases, the rules relating to misrepresentation will apply. In cases involving misrepresentation by omission, the assessment of the risk is based on the objective standard of the reasonable person; in cases involving misrepresentation by commission, the assessment of the risk is based on the subjective standard of the particular insurer.[58]

Of great importance is the fact that this applies only to affirmative warranties. The breach of a promissory warranty, however minor, still allows the insurer to avoid liability on a policy of insurance.

South African Eagle Insurance Company Ltd v Norman Welthagen Investments (Pty) Ltd [59]

A promissory warranty required the insured to keep keys to vehicles in a locked safe. The insured in fact kept the keys in a locked cupboard, and not a safe.

The court held that section 63(3) of the Insurance Act [60] did not apply to this type of warranty and that the insurance company was able to avoid liability.

Parsons Transport (Pty) Ltd v Global Insurance Co Ltd [61]

A contract of insurance included a ‘warranty’ that the premium would be paid by a specified date. The insurer sued for its payment, but was met by a defence that the contract was void and could not be sued on. It was argued that because the payment of premium was a ‘warranty’ its breach had the effect that the contract was void.

The court held that a policy was not automatically rendered void by a breach, as this entitled the insurer only to elect to exercise their right to avoid the policy and repudiate liability. In this case the so-called warranties were not warranties at all but mere material terms of the contract. They did not become warranties merely because they were referred to as such in the contract.

The statutory provisions in effect give less protection to the insured than the common-law position of non-disclosure. The approach has been criticised by our courts.[62]

Non-disclosures and misrepresentations, whatever the materiality test may be, must be distinguished from continuing warranties. A representation is a statement made before the contract is entered into. It is not a term of the

contract and does not become part of the contract. Similarly, non-disclosure is a pre-contractual omission to provide information.

8.2 Incontestability clauses

These clauses have the effect that, after a certain period, the insurer may not avoid a claim because of any misrepresentation, fraud, or any material fact.[63] An insured may pay a higher premium for an insurance contract with this type of clause, but the advantage is that there will be greater certainty for the insured that he or she will be paid out if a claim is made.

8.3 Average clauses

In cases of indemnity insurance it is possible, due to inflation or negligence on the part of the insured party, that the property is insured for less than its market value. This means that the insured is underinsured. Under the common law, the insurer must indemnify the insured party for the full amount underwritten, or to the full extent of the loss, whichever is less. However, most insurers insert special average clauses into contracts of indemnity insurance. In terms of this clause, the insured will bear a proportionate share of the loss to the extent that he or she is underinsured. For example, if a house is insured for R100 000 but its market value is R150 000, then the house is underinsured for 66 per cent of its true value. If the house is destroyed by fire, then the insured will be paid out only 66 per cent of R100 000, which is R66 000.[64]

Mutual and Federal Insurance Company v Chemalum (Pty) Ltd [65]

The insured claimed against loss of gross profits caused by a fire. The business was making a profit of over R5 million; however, had only taken out insurance in the sum of R3 million. It was therefore only insured for approximately 58% of the amount necessary.

The court applied the averaging clause in the contract and reduced the claim from R2 651 585 to R1 537 920.

8.4 Excess clauses

In indemnity insurance, the insured may be liable on the first portion of any claim. This amount is known as the ‘excess’ or uninsured portion of any claim, and generally is specified in the policy document. By choosing to

vary the amount of the excess, the insured may change the amount of the premium payable.

8.5 Forfeiture clauses

A term in the contract may provide that the insurer can avoid all liability in the event of any fraudulent misrepresentation by the insured. This is called a ‘forfeiture clause’. Our courts have generally given effect to forfeiture clauses and have allowed insurers to protect themselves against fraudulent claims even where forfeiture was out of all proportion to the impact of the fraud.[66]

Increasingly, however, our courts interpret forfeiture clauses narrowly. The forfeiture of benefits occurs prospectively in the future, and previously accrued claims are not affected. The insurer has the right to repudiate the whole of a claim that is false only in one relatively minor respect.

Lehmbecker's Earthmoving and Excavators (Pty) Ltd v Incorporated General Insurances Ltd [67]

The policy contained a clause entitling the insured to cancel a contract in the event of a fraudulent claim. The court had to decide whether the insured could recover in terms of two claims submitted – one during the period of cover of the insurance policy; another that he had fraudulently misrepresented had happened during the same time, but which had actually happened before the insurance cover was effected. The insurance company claimed it was entitled to repudiate both claims.

The court held that as from the time the fraudulent claim was made, the insured should have no further benefit or claim under the policy. Therefore a valid claim already submitted would not be affected by the subsequent unrelated fraudulent claim.

The fraud must be such that the insured intends to get money from the policy to which he or she would not be entitled but for the fraud.

Strydom v Certain Underwriting Members[68]

A vehicle had hit the rear of another vehicle. The driver in the claim form alleged that conditions were very bad including heavy rain and slippery roads, and that he was doing a speed far less than that estimated by the other driver. He alleged that a taxi tried to overtake him on the inside and hit the left hand side of his vehicle, causing the collision.

On the facts the court found that it was not raining heavily at the time of the collision, a taxi was not involved in the collision and was not the cause of the collision; and the whole description as to how the vehicles were damaged was untrue.

The court found that the statement made by the insured in the claim form was made knowing it was false with fraudulent intention. Interestingly, even though the version of

the accident was untrue and was designed to show that he was not negligent, it was not necessary for the insured to have done that, since the insured was insured against his own negligence.

Accordingly the court found that the claim for the damage to the vehicle was not affected by the false statement in the claim form, and it did not make the claim itself a fraudulent one. The fact that the statement was knowingly made could not reasonably have influenced the insurer as a prudent insurer to accept, reject or compromise the claim. The statement made did not exaggerate the claim nor did it have the effect of bringing the claim with the intention of seeking to recover something under the policy to which the insured was not entitled, and in that regard the statement was not material.

It is not necessary for an insured to have been paid out under a policy for the forfeiture clause to apply.

Papagapiou v Santam Ltd[69]

The insured tried to bribe an insurance assessor to inflate the amount of damage to a property. The insurance company refused to pay the claim based on an exclusion clause in the insurance policy, which stated that liability was excluded in the face of 'any fraudulent means or devices used by the insured to obtain any benefit under the policy'. The insured argued that the exclusion clause could not be invoked by the insurer, because the fraud was committed before the claim was lodged, and that he had obtained no benefit.

The court held that the clause exactly covered the type of situation where the insured tried fraudulently to obtain an undue benefit.

8.6 Time-bar clause

This type of clause provides that once the insurer repudiates liability for a claim, the insured has only a specified period in which to issue summons against the insurer, failing which the insurer is released from liability. It provides legal certainty for an insurer. An insurer has an interest in knowing within a reasonable time after repudiating a claim whether it will face litigation about it or not.[70]

Napier v Barkhuizen[71]

An insurance policy contained a time-bar clause that released the insurer from liability under a claim unless summons was served within 90 days of the repudiation. Summons was issued two years after the claim was rejected by the insurer.

In deciding whether the insured's right of access to the courts had been violated, the court distinguished between the situation where a plaintiff had a pre-existing right to legal redress, on the one hand, and where no such prior right existed on the other. It held that, in the first situation, a plaintiff's right of access to the courts could not be limited by

imposing an unreasonable time bar or other unreasonable clog on the institution of legal proceedings.

On the facts of the case, however, the second type of situation applied. The insured had no pre-existing right to insurance which the time bar unfairly and improperly impeded. The only right to insurance was created by the insurance contract with the insurer, a precondition for which was that the insured had to institute his claim within 90 days after repudiation by the latter. Failing that, he had acquired no right at all. To provide the insured a different time to institute the claim would be to create a contract for the parties to which they had not agreed.

8.7 Contribution clause

Where the insured has indemnity insurance policies with two or more insurers in respect of the same risk, contribution clauses in the policies may provide that an insurer that pays out the claim may require the other insurers to pay a contribution. In effect, the insured is only entitled to be paid a proportionate share of the claim from each insurer. This means that the insured will only be indemnified once in respect of the loss, and will not profit from being insured more than once.[72]

9 Subrogation

The right of ‘subrogation’ is the right of an insurer who has paid the insurance money to the insured party, to receive the benefit of all the rights of the insured against third parties that, if satisfied, will extinguish or reduce the ultimate loss sustained.[73] The fact that the insured has been indemnified by the insurance company does not prevent the insured claiming against the guilty third party.[74]

The concept of subrogation applies only to indemnity insurance. The insured is entitled to be compensated for loss, but is not entitled to profit. The insurer may not enforce its right of subrogation until it has completely indemnified the insured to the full extent permitted by the policy.

Subrogation allows the insurer to sue in the name of the insured party. If the insurer were to take cession of the insured's rights against the third party, the insurer would have to sue in its own name.[75]

The objectives of subrogation include the following:

- To prevent the insured from receiving double satisfaction, that is, recovering twice in respect of the same loss. A third party may not plead that the insured has suffered no loss after the right has been subrogated to the insurer.
- To enable the insurer to recoup what has been paid out.
- To allow the insurer to sue, and so avoid the publicity that would attach to the use of the insured's own name.

South African law distinguishes between two types of subrogation:

- **Narrow sense**: Subrogation in the narrow sense refers to the right of the insurer to enforce the unenforced rights of the insured party against third parties. This right arises only if the insurer has compensated the insured in full for the loss. The insurer does not require cession to institute action against the wrongdoer: all the insurance company does is to enforce the insured's claim against the wrongdoer. Most policies have clauses that if the company discharges its obligation under the contract

in full, then it is entitled to claim from the wrongdoer. The insured still may sue the third party for the excess.

- **Wide sense**: Subrogation in the wide sense refers to the insurer's right of recourse against the insured party to recover from the insured any amount or benefit the insured has received in respect of the event. The insurance company claims from the insured party what the insured received from the third party, to the extent that the insurance company is out of pocket. Benefit includes any gratuitous payment received by the insured that would allow the insured to benefit from the fact that he or she was insured.[76]

> ***Castellain v Preston and others***[77]
>
> An insured house was sold. After a part of the purchase price had been paid, fire damaged the house. The seller was paid out for the loss by the insurer. After this, the buyer paid the seller the full balance of the price.
>
> The court held that the insurer was entitled to recover from the seller the amount of the insurance money the seller had received.

Subrogation can only operate if the insured in fact has a remedy against the third party.[78] The right of the insurer is simply to make the same claim for damages as the insured could have made; when the latter cannot succeed in a claim for damages against the wrongdoer, neither can the insurer.

Similarly, the insurer must accept any disadvantages in pursuing such a claim. The third party may, irrespective of who brings the action (insured or insurer), raise any defence which would have been available to the third party had subrogation not taken place; for example, that the insured has released the third party from liability or is excluded by agreement from claiming.

> ***Rand Mutual Assurance Co Ltd v Road Accident Fund*** [79]
>
> An insurance company paid out an insured, and then exercised its rights of subrogation and instituted action in its own name against the wrongdoer. The court had to decide whether the subrogation doctrine required the insurer to sue in the name of the insured.
>
> The court held that the requirement to litigate in the name of another was not transparent. The rule served no public interest in modern times. However, the court did not want to upset settled legal principles, even where they were based on incorrect assumptions of law. Accordingly it held that a strict application of subrogation could not be justified and that, unless the wrongdoer would be prejudiced, the court would allow the insurer to institute proceedings against the wrongdoer in its own name.

10 Legislation

Insurance law in South Africa is based on the common law, but also is regulated largely by two pieces of legislation:

10.1 Long-Term Insurance Act[80]

This legislation deals mostly with the following types of insurance policies:

- **Assistance policy**: A life policy in terms of which the value of policy benefits is less than R10 000.
- **Disability policy**: Benefits are paid if a ‘disability event’ occurs. This means that the functional ability of the mind or body of a person or an unborn becomes impaired. For the purposes of the Act, an unborn is defined as a human foetus conceived but not born, the life of which is deemed to begin at conception.
- **Fund policy**: Benefits are paid for the purpose of funding the liability of a fund to provide benefits to its members.
- **Health policy**: Benefits are paid on the occurrence of a health event, relating to the health of the mind or body of a person or an unborn. This type of contract does not include providing anything other than money, or defraying the expenses of a health service.
- **Life policy**: An annuity is paid for a period as a result of, a ‘life event’. This means the life of a person, or an unborn, having begun, continuing, having continued for a period, or having ended.

10.2 Short-Term Insurance Act[81]

This legislation deals mostly with the following types of insurance policies:

- **Engineering policy**: Benefits are paid if a risk event occurs relating to the possession, use, or ownership of machinery or equipment (other than a motor vehicle) in the carrying on of a business; the erection of buildings or structures; or the installation of machinery or equipment.
- **Guarantee policy**: Benefits are paid if a risk event occurs relating to the failure of a person to discharge an obligation.

- **Liability policy**: Benefits are paid if a risk event occurs relating to the incurring of a liability.
- **Motor policy**: Benefits are paid if a risk event occurs relating to the possession, use, or ownership of a motor vehicle.
- **Accident and health policy**: Benefits are paid if a risk event occurs relating to disability, health or death.
- **Property policy**: Benefits are paid if a risk event occurs relating to the use, ownership, loss, or damage to movable or immovable property.
- **Transportation policy**: Benefits are paid if a risk event occurs relating to the possession, use, or ownership of a vessel, aircraft, or other craft for the conveyance of persons or goods by air, space, land, or water, or for the storage, treatment, or handling of goods so conveyed.

The Act also deals with the protection of policyholders by the creation of the Policyholder Protection Rules. These rules ensure that a consumer is provided with sufficient information to make an informed choice about insurance products before a purchase is made, and to provide for measures to ensure consumer protection.

PRACTICALLY SPEAKING

What types of insurance should you have for your business? [82]

There are many different types of insurances available for business. Here is a list of the main compulsory insurances that your businesses ‘must have’, ‘should have’, and ‘could have’ to protect your business.

Business insurance policies you must have:

- **Workers compensation insurance**: Once you take on your first employee, you are required by law to make contributions for your employees' occupational illness or injuries. This will protect your employees if they fall ill with an occupational disease or if they are injured in the course of their work. Your insurance certificate must be displayed where your staff can see it.
- **Premises insurance**: Even if you just rent the premises you should investigate insuring the place against fire, flood or other damage. Your insurable interest is the possibility of commercial loss if the premises are destroyed or unusable and your business has no place from which to operate, and yet you may still have to pay rent in terms of a lease agreement.

  You should also take out insurance against loss or damage to the contents of the premises due to fire, theft or any other cause. It is very important to look at how

quickly the insurance will be paid out in the event of a fire or other catastrophe. If you lose all your stock in a fire, how long will your business survive if the insurance company takes a long time to pay?

- **Motor vehicle insurance**: If you operate company vehicles, you must have at least third party insurance, and preferably fully comprehensive. It is very important to tell the insurance company that the vehicle will be used for business purposes, even if this means the premium is higher. Remember also that employees may be less likely to look after a company vehicle, so you may find yourself claiming on your policy more often than you would expect to with a private car.
- **Industry-specific insurance policies**: Attorneys, accountants, architects and doctors are required to carry insurance policies in order to practice their professions. If you are part of a recognised profession, check with your industry body what insurance policies they insist, or recommend you hold.

Business insurance policies you should have:

- **Public liability insurance**: Public liability insurance is essential if members of the public come to your premises, or could be hurt in any way by something your business does. A public liability insurance policy will cover you for any damages claimed, and in some cases also cover the costs of hiring attorneys.
- **Product liability cover**: If you make, repair or sell products, you could be held liable for any injury or damage caused by defects.
- **Professional indemnity insurance**: Professional indemnity gives professional businesses protection against claims made by their clients, for any damage caused by professional negligence. It is advisable to have professional indemnity insurance if you offer any kind of service to businesses or the public.
- **Pollution risk insurance**: If you manufacture anything and there's any risk you might pollute the environment, this will cover the costs of any clean up operation, plus claims against your business.

A selection of more specific business insurance policies you could buy:

- **Director's and Officers insurance**: Director's and Officers insurance covers the legal liabilities you have as a director of a limited company and any legal costs if you get something wrong.
- **Key person insurance**: If your business would grind to a halt if you or someone else was badly injured or killed, key person insurance will protect the business against loss of revenue while a replacement is found.
- **Business continuity insurance**: Also called business interruption insurance, this will protect you against any disruption that could lead to loss of revenue, such as a major catastrophe. You should aim to cover events not already covered by your contents insurance, or where there will be a longer-term disruption (such as total loss of premises).
- **Fidelity guarantee**: Protects your business against loss of money or stock if one of your employees is dishonest. Unlikely to be cost effective until you have a significant number of employees.
- **Glass and sign cover**: If you have a shop with a large window or expensive signage, it may not be covered by other policies if it is destroyed or damaged by vandals.
- **Plant and business equipment cover**: If you rely on key expensive machinery, get it insured in case it is damaged or stolen.
- **Goods in transit cover**: If you shift large amounts of stock around, this will give you extra protection from accidents or theft.

- **Money insurance**: If you hold large amounts of cash or other valuable documents, this may offer you some protection against loss or theft.
- **Trade credit insurance**: Will pay out if you have a bad debt. Definitely worth looking at if you sell a small number of high value items.
- **Engineering insurance**: Provides cover against electrical or mechanical breakdown of essential equipment.
- **Employee travel insurance**: If you require your employees to travel abroad, you should get them well insured with a reputable company that will look after them in an emergency. Remember to check that their luggage, money and laptop will be covered.

Remember to get professional advice from a qualified person before buying any insurance cover.

THIS CHAPTER IN ESSENCE

1. An insurance contract is between an insurer and an insured, by which the insurer undertakes, in return for the payment of a premium, to give the insured a sum of money or its equivalent, on the occurrence of a specified uncertain event in which the insured has some interest.
2. South African law recognises two types of insurance contracts: indemnity insurance and non-indemnity insurance.
3. If a person can show that he or she stands to lose something of an appreciable commercial value by the destruction of the thing insured, he or she has an insurable interest in the thing insured even when he or she does not necessarily have a personal or real right in the thing.
4. The law creates a duty of disclosure on the insured, who must answer questions put to him or her in the proposal form both truthfully and accurately, and is obliged to volunteer knowledge material to the risk.
5. The duty of disclosure will arise at different times for indemnity and non-indemnity insurance.
6. A fact that is material to the risk is every circumstance that a reasonable person might suppose could in any way influence the insurer in considering whether it will enter into the contract at all, and on deciding the terms of the contract, such as the amount of the premium.
7. Misrepresentation by commission or by omission amounts to a breach of the insured's general duty to make disclosure.
8. A warranty is a statement upon the exact truth of which, or the performance of which, the validity of the contract depends. Our law distinguishes between affirmative warranties and promissory warranties.

QUESTIONS

Short questions (1–5 marks)

1. Define indemnity insurance.

2. Define non-indemnity insurance.
3. What are the four essential elements in any contract of insurance?
4. What is an affirmative warranty?
5. What is a promissory warranty?

Paragraph questions (5 marks)

1. Distinguish between indemnity and non-indemnity insurance.
2. Discuss what is meant by the duty of disclosure.
3. What is an averaging clause?

Essay questions (10 marks)

1. Discuss the requirement to have an insurable interest for indemnity insurance.
2. Discuss what is meant by subrogation and discuss the doctrine of subrogation in insurance law.

Problem questions (20 marks)

1. Barry agrees to insure his jewellery shop with Rip-Off Insurance Company after they told him he would be comprehensively covered against all risks. The contract includes a clause that his cover will only continue if he obtains an annual security certificate to the effect that all reasonable precautions against theft were being taken. Barry signs the contract without reading it and consequently does not obtain the necessary security certificates each year. Rip-Off refuses to pay Barry when the shop is broken into one night and everything is stolen. Advise Barry.
2. Abel signs a proposal form for a life insurance policy and sends it to an insurance company. Though no medical examination is required, the proposal form asked whether Abel has seen a doctor during the past two years. Abel has not seen a doctor during the past two years, but six years ago his doctor told him that he had tested positive for HIV (human immunodeficiency virus) and probably would die soon. Abel does not disclose this to the insurer. Abel dies and his wife claims on the policy. Consider the following situations:

a. Is the insurance company obliged to pay?
b. Would your answer be different if the proposal form stated the following: ‘No medical evidence required. All applications accepted.’

3. Jenny owned an antique shop, which was accidentally destroyed by fire. Peter and Jenny were married in 1980, without an antenuptial contract. Peter managed the shop for his wife, and had insured the shop with Vrot Insurance Company. Peter claims and Vrot Insurance refuses to pay out, stating that Peter did not have an insurable interest. Advise Peter. Would your answer be different if they were married in 1985 with an antenuptial contract?
4. Patricia's car is insured for R40 000. After it was involved in a collision, it was examined by an assessor from the insurance company, and the costs to repair the vehicle were assessed at R10 000. Patricia offered the assessor R1 000 if he would assess the damage at R35 000. Advise the insurance company.

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1 *Lake v Reinsurance Corporation Ltd* 1967 (3) SA 124 (W); Gibson, 533–534.

2 *British Oak Insurance Company Ltd v Atmore* 1939 TPD 9.

3 Fouché, 269–270; Gibson, 507–508; Havenga et al., 140; Sharrock, 368.

4 Havenga et al., 140–144.

5 *Department of Trade and Industry v St Christopher Motorists Association Ltd* 1974 All ER 395.

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8 *Sydmore Engineering Works (Pty) Ltd v Fidelity Guards (Pty) Ltd* 1972 (1) SA 478 (W).

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21 Short-Term Insurance Act 53 of 1998.

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30 *Qilingele v S A Mutual Life Assurance Society* 1993 (1) SA 69 (A).

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33 Short-Term Insurance Act 53 of 1998.

34 Long-Term Insurance Act 52 of 1998.

35 Short-Term Insurance Act 53 of 1998.

36 *Santam Limited v Van Schalkwyk* 2002 (4) SA 193 (O).

37 *Liberty Life Association of Africa Limited v De Waal* 1999 (4) SA 1177 (SCA).

38 Sharrock, 374–376.

39 *Van Zyl and Maritz NNO and others v South Africa Special Risks Insurance Association and others* 1995 (2) SA 331 (SE).

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41 *Commercial Union Insurance Co of SA Ltd v Lotter* 1999 (2) SA 147 (SCA).

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53 *Cole v Bloom* 1961 (3) SA 422 (A).

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56 Section 53 of the Short-Term Insurance Act 53 of 1998.

57 Section 48 of the Long-Term Insurance Act 52 of 1998.

58 *Qilingele v S A Mutual Life Assurance Society* 1993 (1) SA 69 (A).

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62 *Clifford v Commercial Union Insurance Co of SA Ltd* 1998 (4) SA 150 (SCA).

63 *Borwein's Executor v African Life Assurance Society Ltd* 1923 WLD 5.

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Chapter 20

Real and personal securities

'Rule No. 1: Never lose money. Rule No. 2: Never forget rule No. 1.'

WARREN BUFFETT (1930–)
AMERICAN BUSINESS MAGNATE, INVESTOR, AND PHILANTHROPIST

What is covered in this chapter

1 Introduction
2 Real securities
3 Personal security
4 Personal and real securities compared
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

If you are thinking about giving someone credit, your decision will depend largely on the prospects of getting your money back. How likely is it that the debtor will breach the contract or go insolvent? What can the debtor do to provide security for the debt?

There are generally two ways to provide this security. Firstly, you can get some sort of right over the debtor's property, so that you can sell it if necessary to get your money back. Secondly, you can get another person to promise to pay the debt if the debtor is not able to.

This chapter sets out the forms of real and personal security available to secure debts. It is important that you understand the ways that such security can be created, and the rights that each person has.

1 Introduction

A creditor may try to obtain ‘real security’ or ‘personal security’ to ensure performance of an earlier contract which gave rise to the principal obligation.

Real security refers to the situation where a particular asset belonging to the debtor is earmarked for the satisfaction of the creditor's claim. For example, mortgage, pledge or lien.

Personal security refers to the situation where a person other than the debtor holds himself or herself liable for the debt. For example, suretyship.

A right of security, whether real or personal, is ‘accessory’ to the obligation it secures. This means that it is dependant on the existence of the agreement it is securing. If the principal obligation is void, or is subsequently terminated, then the right of security may similarly be void or unenforceable. The opposite does not apply: the existence of the principal obligation does not depend on the existence of the security, and the principal obligation will continue even where the right of security is terminated.[1]

The security can cover the whole of the obligation or just a part of it. A principal obligation need not be in existence at the time the security is created, in which case the security is suspended until the coming into existence of the principal obligation.

2 Real securities

A real security gives the creditor a real right to an asset. For example, mortgages, pledges, liens, and hypothecs, are all real securities because they give creditors real rights.[2] Both a mortgage and a pledge follow after an agreement and are known as ‘conventional securities’. Both a lien and a hypothec arise by operation of law and are called ‘tacit securities’ or ‘legal securities’.

A mortgage, pledge, lien or hypothec therefore pass real rights to a creditor over the property of the debtor in order to secure performance of an obligation.

2.1 Mortgage

The word ‘mortgage’ refers to the real right of one person called the mortgagee (or bondholder) over the property of another person, the mortgagor (or debtor), as security for the payment of a debt. The property must be in the form of an immovable asset or assets.[3]

A ‘mortgage bond’ is the name of the document that is registered to create a mortgage. The real right is created only on registration of the mortgage bond. The mortgage bond must be prepared by a specialist attorney called a conveyancer.

In terms of the Deeds Registries Act,[4] registration takes place by an official called a registrar of deeds signing the mortgage bond. The time of registration will be important if two or more conflicting real rights are registered on the same day: the holder of the real right that originated first will be in the stronger position.

The rights of the mortgagee are as follows:

- The mortgagee has a real right over the property.
- The mortgagee enjoys a claim of preference upon insolvency.
- The mortgagee's rights extend over additions to the property.

What the mortgagee obtains is a right to keep control over the property until the mortgagor pays the debt. The mortgagee does not get ownership of the

property; this stays with the mortgagor. However, if the mortgagor defaults, the mortgagee can institute legal action and have the property ‘attached’ and ‘sold in execution’. The mortgagor then loses ownership and the mortgagee would receive payment from the proceeds of the sale.

The duties of the mortgagee are to:

- Take care of the property once it has been placed under the mortgagee's supervision.
- Return the property with all additions upon the settlement of the debt.
- Account for all proceeds or ‘fruits’ produced from the property. If the mortgagee has a right to the fruits, the mortgagee may enjoy the fruits only for his or her own account. If the mortgagee does not have a right to the fruits, their value must be deducted from the debt owed.

The mortgage may be terminated by any of the following:[5]

- Discharging the principal debt through payment, novation, set-off, release, merger, or in any other way.
- Release of the mortgage.
- The sale of the mortgaged property by the debtor with the consent of the creditor.
- Destruction of the mortgaged property.
- Expiry of the period set for the duration of the mortgage.
- Prescription of 30 years, provided prescription is not interrupted.
- Sale of the mortgaged property in execution or on insolvency.
- Mortgagor loses title to the property.
- Fulfilment of the condition on which the mortgage is dependent.
- An order of the court setting the mortgage aside. For example, if it was fraudulently constituted.

Our law provides for several different types of mortgage bonds.[6]

A *kustingbrief* is a special mortgage over immovable property. It is made at the same time as property is transferred into the name of the buyer. It is made in favour of the seller of that property, for a part of the price that the buyer is allowed to retain on loan, or in favour of other persons, for monies lent by them to the buyer in order to enable the buyer to pay the price of the property mortgaged. For example, if you were only able to afford 90 per cent of the purchase price of a house, the seller could loan you

the ten per cent you needed to pay the full price, in return for a mortgage over the house in the seller's name for the ten per cent amount.

A ‘notarial bond’ is a form of mortgage. It is defined by the Deeds Registries Act[7] as a bond attested by a notary public, that ‘hypothecates’ movable property either specially or generally. Hypothecation means to pledge property as security or collateral for a debt. A notarial bond resembles a mortgage in that it must be registered before any rights are created. A notarial bond also seems similar to a pledge in that they both concern movable assets. But with a notarial bond there is no requirement of delivery of the assets concerned to the creditor. A notarial bond differs from both a mortgage and a pledge in that it does not generally create a real right of security in the creditor, but merely a preference on the insolvency of the debtor.

Ikea Trading und Design AG v BOE Bank Ltd [8]

BOE was the holder of a general covering notarial bond over the assets of an insolvent corporation. Ikea also had a bond registered over the assets of the insolvent. BOE applied to court to exclude Ikea from being a preferential creditor from the insolvent estate because the bond in favour of Ikea failed to specify and describe the assets in a way that made the assets readily recognisable. Ikea argued that the property listed in the bond could be identified with the aid of extrinsic evidence, and it therefore had a deemed pledge in the assets, and accordingly ranked as a secured creditor in the insolvent estate.

The court held that a bond had to specify and describe the property so as to render it readily recognisable. A third party had to be able to identify the items by reference to the document alone by correlating the descriptions contained in it with property fitting such descriptions. In this case the items listed had not been specified and described in the manner required by the Security by Means of Movable Property Act.[9] The bond had failed to create a deemed pledge over the insolvent's property, with the result that Ikea was not a secured creditor.

There are five different types of notarial bond:

- **Covering bond**: This is a notarial bond securing future debts. A covering bond is not valid unless it clearly states that it is intended to secure a future debt, and states the maximum amount it will secure.
- **Collateral bond**: This is passed by the debtor to secure an obligation for which he or she has already given security, such as a mortgage bond.
- **Surety bond**: This is a means by which a surety secures his or her obligation to the creditor.

- **Indemnity bond**: This bond may be passed by a principal debtor to secure his or her obligation to pay a surety.
- **Participation bond**: This is a notarial bond used by a small investor who invests in an investment company that grants loans against registration of mortgage bonds over specified immovable property. Once registered the investor receives a letter of participation advising that the amount invested is secured by the bond.

2.2 Pledge

A ‘pledge’ is a contract by which a debtor (pledgor) places movable property in the hands of a creditor (pledgee) as security for a debt.[10]

A pledge is a limited real right of security in another person's movable asset. It is created by the delivery of the asset to the pledgee to secure the fulfilment of an obligation due to the pledgee by the pledgor or some third person. It is therefore the right of one person over the movable property of another as security for a debt, and it is created by delivery. Ownership of the pledged property normally remains with the pledgor.

A pledge is an accessory right of security to an obligation. Therefore, a pledge will not be valid unless the principal obligation is valid.

No formalities have to be complied with for there to be a valid pledge. All that is required is that the parties must give their consent to the pledge, the pledgor must intend to transfer the property, and the pledgee must intend to keep the property as security for the fulfilment of an obligation.

A pledge is created in one of two ways:

- Agreement, plus delivery of the movable property to the pledgee.
- Execution of a special notarial bond or a general notarial bond over the movable property. This document must be signed in front of a special attorney called a notary public and must be registered by a registrar of deeds.

Normally, a pledge of movables is effected by delivering the goods to the pledgee, together with an agreement that they are to be held as security. Delivery and possession are essential for the existence of the real security.[11]

However, a pledge may also be made contractually by registering a notarial bond over the movables.[12] In this case, the requirements of delivery

and possession will not be necessary. The Security by Means of Movable Property Act[13] also provides that movable property over which a notarial bond has been validly drawn and registered cannot be subject to a landlord's tacit hypothec.

Virtually anything movable that can be bought or sold may be the subject of a pledge, provided there is actual or constructive delivery by the pledgor to the pledgee. Movable incorporeal rights (for example shares) may be pledged validly by effecting the cession of the right to the pledgee.[14] This type of cession is called a ‘cession to secure a debt’ or a cession *in securitatem debiti*. The cession may be oral or written. If in writing, the document (for example a share certificate) must be delivered to the pledgee to be effective against other creditors.[15] Although an incorporeal can be the subject of a valid pledge, certain pension funds are protected by statute and may not be pledged.

What the pledgee obtains is a right to keep control over the property until the pledgor pays the debt. The pledgee does not get ownership of the property: this stays with the pledgor. However, if the pledgor defaults, the pledgee could institute action and have the property attached and sold in execution. The pledgor then loses ownership and the pledgee would get payment from the proceeds of the sale.

Our law prohibits any agreement that the pledgee may keep the security as his or her own property if the pledgor defaults. One exception, however, is where the pledge gives a fair price for the security, with a valuation to occur at the time the debt falls due. Where the goods are sold and any excess value is realised, the excess must be returned to the pledgor.[16]

Graf v Buechel [17]

Buechel was the sole shareholder and director of a company. He delivered his shares, together with signed share transfer forms that did not specify a name as to the transferee, to Graf as security for money lent to the company. The money was going to be used by the company to buy a property. The agreement allowed Graft to take transfer of Buechel's shares if the company defaulted on any loan repayment. The company failed to repay its indebtedness to Graf and he took transfer of the shares. Buechel went to court to undo the transfer on the basis that the agreement was invalid.

The court held that where pledged goods are held as security, and it becomes necessary to realise that security to satisfy or liquidate an indebtedness, due process must be followed in regard to the realisation of that security. Where the contract simply provides that on default the pledgee is entitled to choose to take the property for himself, the contract is prohibited and invalid.

A ‘judicial pledge’ will arise where a creditor, having been granted a monetary judgment against a debtor, is entitled to have issued a writ of execution. This serves as a warrant to a deputy sheriff to take possession, by ‘attachment’, of sufficient property of the debtor up to the value of the judgment and costs. If there is insufficient movable property to satisfy this amount, sufficient immovable property of the debtor will be attached and sold by public auction. The judgment creditor, by virtue of the attachment in execution, obtains a real right in the property attached. A judicial pledge automatically terminates on the insolvency of the judgment debtor.

The rights of the pledgee are to:

- Acquire a real right over the pledgor's property that serves as security for the debt.
- Sell the goods if the pledgor does not pay. The parties may agree that on the default of the pledgor the pledgee may sell the pledged property without a court order being obtained first. This is known as a ‘help yourself’ or *parate executie* clause.
- Have rights extended over additions. For example, if a pledged sheep gives birth to lambs, then the pledge extends to the lambs.
- Recover expenses for the proper maintenance of the thing pledged.

The duties of the pledgee are to:

- Take care of the pledged property.
- Return the property upon payment of the debt, together with any increase accrued. For example, both sheep and lambs must be returned.
- Deduct from the amount of the debt owed, the value of any fruits of the property that the pledgee has used for his or her own benefit.

In terms of our law, the parties to a pledge will bear certain rights and duties to each other. The pledgee will be liable to the pledgor for:

- Redelivery of the property pledged (or its value if negligently lost by the pledgee), once the debt has been paid in full plus interest.
- Damage caused to the property through the fault of the pledgee.
- Delivery and a full accounting of all the proceeds or fruits that have resulted from the property pledged.

- An accounting of the sale of the property to satisfy the debt, plus any proceeds remaining after the debt has been satisfied.

A pledge will be terminated on any of the following grounds:

- If the pledgee voluntarily loses possession of the pledged property.
- Extinction of the principal obligation.
- Destruction of the pledged property.

2.3 Lien

A lien is a right of retention. It arises from the fact that one person has put money or money's worth into the property of another.[18]

In legal terms, a lien is the right acquired by a person who is in possession of someone else's property until he or she is refunded for expenditure on the article, or paid for his or her labour in respect of the article. For example, a garage may have a lien over a motor vehicle in respect of repairs undertaken.

A lien is dependent on possession. Generally, the right of retention is lost forever once possession is lost, even if possession is subsequently regained.[19]

The concept of possession has two elements:

- Physical control or occupation of the property.
- Intention of holding and exercising that possession.

It is this essential requirement of possession that distinguishes a lien from a tacit hypothec. Possession is not necessary in the case of a tacit hypothec. Where possession is lost through fraud, force, or mistake, the lien-holder who has lost possession may apply to court for an order of restitution. In such a case, the lien may be revived on recovery of possession.[20] For example, a garage may keep possession of a vehicle it has repaired until the bill is paid. If the owner drives the car away without paying, the garage may apply to court to get the vehicle back into its possession.

The right to retain possession arises automatically from operation of law from the mere doing of the work and the possession of the property. The lien in itself does not create a cause of action to sue the other party for

payment. Rather, the cause of action arises from the contract, or, if there was no contract, on the basis of unjustified enrichment. Therefore, the creditor always has an action against the debtor for payment of expenses, which is distinct from the lien he or she may also exercise over the debtor's property.[21]

Unless there is an agreement to the contrary, the creditor may not sell property over which he or she has a lien in order to recover damages. The creditor must first get a court judgment against the debtor, and then have the goods attached, removed, and sold by a deputy sheriff at an auction.

South African law recognises two different types of lien:

- **Debtor and creditor lien**: This type of lien may arise where expenses have been incurred on the owner's property, with the express or implied consent of the debtor. For example, a motor vehicle is taken to the garage for repairs.[22]

  The creditor also has a lien for the contract price where this has been fixed or, where there has been no contract, for the reasonable costs under the circumstances.[23]

  Van Niekerk v Van den Berg [24]

  Grazing was provided for cattle.

  The court found that while the cattle were on the grazing land the owner of the land had a lien over the cattle for the agreed grazing fees.

- **Enrichment lien**: This type of lien may arise where expenses have been incurred on the owner's property without the explicit or implicit consent of the debtor. For example, you borrow a car from the owner. The car breaks down and you take it to a garage for repairs, and you pay the bill. You may legally keep possession of the car until the owner pays you for the repairs.

  An enrichment lien is a real right operating against the world at large. There are two types of expenditure that can be secured by enrichment liens. ‘Necessary expenses’ may be claimed if they were incurred for the preservation or protection of the property. A lien for recovery of necessary expenses is sometimes called a ‘salvage lien’. ‘Useful expenses’ may be claimed if they were incurred to enhance the market

value of the property, even though not necessary for protection or preservation. This type of lien is sometimes called an ‘improvement lien’.

For a person to gain a lien over property, he or she must incur expenditure or make improvements to it while it is in his or her possession.[25] It is important to note that a lien will not arise over a lease of urban property.

Business Aviation Corporation (Pty) Ltd and another v Rand Airport Holdings (Pty) Ltd [26]

The court examined the role of *placaeten* promulgated by the Estates of Holland of 26 September 1658 and 24 February 1696. In this case the parties had entered into an oral lease over part of an airport. The lessee was then served a month's notice of termination, but it argued that as it had not been compensated for necessary and useful improvements made to the property, it could not be required to vacate.

The court examined the Roman-Dutch law, where lessees were originally in the same position as possessors in good faith regarding claims for improvements to leased properties. Therefore lessees, like *bona fide* possessors, had an enrichment lien for the recovery of expenses that were necessary for the protection or preservation of the property as well as for expenses incurred in effecting useful improvements to the property. Lessees, like possessors in good faith who were still in possession of the leased property, also had an enrichment lien that allowed them to retain the property until their claims for compensation had been satisfied.

However, the court held that provisions of the Roman-Dutch law never applied to urban leases. As the lease in the case was an urban one, there was no claim for the recovery of expenses incurred in effecting necessary and useful improvements to the property.

The court may also order the person who holds the lien to accept a substitute form of security.[27]

A lien will terminate on any of the following events:

- **Refund of expenditure or payment for the labour**: The right of retention only exists as a form of security to ensure that such payment is made.
- **Loss of possession**: The moment the property is out of the possession of the creditor, the lien is lost. The lien does not revive unless the dispossession was fraudulent.[28]
- **Furnishing of security by the owner**: The need for the lien falls away.

2.4 Landlord's tacit hypothec

This form of security has been discussed in chapter 18 on the law of lease.

In addition to the landlord's tacit hypothec providing security for unpaid rent, it also provides the lessor of rented premises a preferential right in regard to movable assets of the tenant found on the premises upon sequestration of the tenant's estate.

3 Personal security

3.1 Suretyship

‘Suretyship’ is a form of personal security given by a debtor to a creditor in terms of which a third person undertakes to perform the obligations of the debtor if the debtor fails to do so.

For the suretyship to be valid, it requires a valid principal obligation, that is, a valid previous contract of some sort between the debtor and the creditor. We can therefore say that suretyship is an ‘accessory contract’, because it requires another contract – the principal contract – in order to be valid. If the principal contract is void, then the suretyship contract will also be void.

BOE Bank Ltd v Van Zyl [29]

The defendant was an experienced businessman who was the father-in-law of a man who ran a second-hand car dealership that ran into trouble. After two meetings the bank explained that it was considering laying criminal charges of fraud against the son-in-law, or sequestrating him. The defendant then signed a suretyship agreement in favour of the bank. After the business finally closed its doors and the bank claimed on the suretyship, the defendant claimed that he had only entered into the contract of suretyship because of duress. He said that he was particularly upset with the possibility that his son-in-law could go to jail, and the impact this would have on his daughter and his grandchildren.

The court held that the requirements for the defence of duress are settled in our law.[30] The court found that there had been no immediate threat. On his own version, the bank did not place pressure on him immediately to sign the suretyship. The danger of the son-in-law being sent to prison depended on the facts and the legal position. There was nothing that prevented the defendant from conducting a proper investigation into the facts and the legal position, before he decided to sign the suretyship.

The court also held that laying criminal charges against the son-in-law would not have been unlawful. The test in our law remains whether the creditor's actions considered in light of all the circumstances, (including the nature of the benefit obtained under duress) are, according to the legal conviction of the community, considered unacceptable.

The court also found that the bank's actions were not against public policy. The bank manager had spelled out various options, including the possibility that criminal steps may be taken against the son-in-law. Even if such steps were taken, it was only a further possibility that he may be imprisoned. The defendant had ample time to reconsider the matter, before he signed the suretyship. The court held that the defence of duress could not succeed.

The principal contract does not have to exist at the time the suretyship is entered into. If the principal obligation never comes into existence, then the surety is never bound.[31]

In a contract of suretyship the ‘surety’ agrees to pay jointly and severally with the principal debtor, the whole or part of an obligation due by the ‘principal debtor’ to the creditor.[32]

The person who undertakes the principal obligation is called the surety. The original debtor is called the principal debtor; the debt is called the ‘principal debt’. The person to whom the debt is owed is called the creditor. The principal debtor remains bound to the creditor in terms of the principal obligation and the surety is bound to the creditor in terms of the contract of suretyship. Once the principal obligation ends, the suretyship obligation is terminated.

The capacity of the surety may affect the validity of the suretyship. A tacitly emancipated minor cannot enter into a contract of suretyship without his or her guardian's consent. Similarly, a person married in community of property cannot bind himself or herself as surety without the consent of the spouse.[33]

3.2 Suretyship compared to indemnity and insurance

An ‘indemnity’ is an agreement in terms of which the promissory enters into an original contract to make good the loss which the promissee may suffer. This type of contract can be distinguished from a contract of suretyship because the obligation of an indemnifier is not dependent on the existence of a valid principal obligation.

Suretyship differs from contracts of indemnity and contracts of insurance, as illustrated in Table 20.1.

Table 20.1 *Suretyship and contracts of indemnity and insurance*

	Suretyship	Indemnity	Insurance
Nature of obligation	An ancillary obligation generally dependent on the existence of a valid principal obligation.	A principal obligation.	Entails reciprocal obligations.
Type of contract	An accessory contract.	A principal contract.	A principal contract.
Payment	Does not require the payment of a fee.	Requires the payment of a fee.	Requires the payment of a fee.
Formalities	Must be in writing.	May be verbal or written.	May be verbal or written.
Relationship to third party	A contract must exist between the surety and the creditor.	The contract need not exist between the indemnifier and a third party being paid.	A contract need not exist between the insurer and a third party being paid.
Rights of recourse	If there is no specific exclusion in the written contract, the surety obtains automatic rights of recourse against the principal debtor.	The indemnifier obtains no automatic right of recourse against the person causing the loss.	In a written contract of insurance, the insurer obtains rights of subrogation to recover damages from the person who caused the loss.

Hutchinson v Hylton Holdings and another [34]

A property was sold to a company that did not exist. A third person had provided the seller with an undertaking that he would 'guarantee specific performance of the contract'. When sued, he argued that he could not be held liable on a suretyship for a non-existent debt.

The court held that the third party had contracted as a co-principal debtor, and not as a surety. His undertaking was not dependent on the non-performance of the buyer. The clause was a form of indemnity and was not affected by the invalidity of the main contract.

Suretyship is also different from a warranty, in that a debtor who supplies a warranty does so in respect of his or her own performance.

3.3 Formalities

Previously, no formalities were required to enter into a contract of suretyship. The General Law Amendment Act[35] now requires that the terms of a suretyship agreement be in writing and the document signed by or on behalf of both the surety and the creditor.

Nelson v Hodgetts Timbers (East London) (Pty) Ltd [36]

Two people agreed to be sureties and co-principal debtors. One of them had signed in the space on the document provided for his signature; the other had not.

The court held that since the parties had intended to enter into a joint contract of suretyship, in the absence of the signature of one of them, the contract was invalid.

Therefore, a valid contract of suretyship will require all of the following to be in writing or ascertainable from a written document:

- Identity of the creditor.
- Identity of the principal debtor.[37]
- Identity of the surety.
- Nature of the principal debt.
- Amount of the principal debt.[38]

Inventive Labour Structuring (Pty) Ltd v Corfe[39]

An error of both parties resulted in the name of the principal debtor being inserted in a suretyship agreement in the place of the name of the surety.

The court had to decide whether the deed of suretyship could be rectified. This involved a two-stage inquiry. The first was to determine whether the formal requirements contained in the General Law Amendment Act[40] were met by checking whether the written document appeared to be a valid contract of suretyship. If it did not, the inquiry ended there. If it did, then the second stage focused on whether a proper case for rectification had been made out.

It must be evident that the agreement is one of suretyship for the contract to be valid.

Brink v Humphries and Jewell (Pty) Ltd [41]

The appellant claimed that when he signed a credit application form on behalf of the company, he did not read the form, nor did he know that it included a personal suretyship obligation. He claimed the suretyship was not conspicuous, was not brought to his attention and he did not expect it.

The court held that the manner in which the personal suretyship clause had been included in the credit application form was not sufficient to alert a signatory to the fact that he was undertaking a personal obligation. The form was a trap for the unwary and the appellant was misled by it. The suretyship obligation was therefore void.

An oral variation of the written agreement will not be binding. However, it is possible to lead evidence in court to identify any of the parties, to prove the amount of the principal debt, or to prove the terms of the contract by referring to other documents that have been incorporated by reference.

What is the situation if the contract has blank spaces to be filled in, which are in fact not filled in? The answer depends on whether the blank spaces related to material terms or not. If the terms are material, the contract of suretyship will be void.[42]

If the clauses are not material (for example a clause relating to an address), then the failure to fill them in simply means that the parties intended particular clauses not to apply. It does not mean that the whole contract of suretyship is invalid.[43]

***Nedbank Ltd v Wizard Holdings (Pty) Ltd and others*[44]**

The bank applied for summary judgment against sureties for a close corporation. The sureties said that the suretyship was invalid, because at the time of signing there was a blank space relating to the limit of the undertaking. The blank space was later filled in by the bank which wrote the word ‘unlimited’.

The court held that the limit of a surety's liability was obviously significant to the parties; however, a limitation of liability was not one of the essential terms for the coming into existence of a surety relationship. The mere fact that a blank space pertaining to a non-essential term was not completed did not mean that the agreement was void for non-compliance with the statutory formalities.

As long as the surety has the capacity to enter into a contract, he or she generally will be able to enter into a written contract of suretyship without any further formalities. However, if a tacitly emancipated minor wishes to become a surety, he or she requires the consent of the guardian before entering into the suretyship contract. Alternatively, the minor may validly ratify the unassisted suretyship contract after obtaining majority. Also, if spouses are married in community of property, and one spouse wishes to bind himself or herself as a surety, then the other spouse must agree.[45]

3.4 The nature of the principal debt

The principal debt has the following characteristics:

- **The principal debt must be valid**: If the principal debt is invalid, the contract of suretyship is also invalid. If the principal debt is void for a common-law reason such as mistake, or for a statutory reason such as prescription, the suretyship will also be void.[46]

> ***Metequity Ltd NO and another v Heel*** [47]
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> The surety had bound herself as surety and co-principal debtor with the principal debtor. The principal debt arose from a transaction that was void in terms of section 38 of the Companies Act.[48] The defendant raised this as a defence. The surety argued that because the principal debt was void, the suretyship, being an accessory obligation, was unenforceable. The plaintiff argued that because they had obtained a court judgment against the principal debtor, that the judgment had created a new and independent debt also covered by the suretyship.
>
> The court relied on the case of *Swadif (Pty) Ltd v Dyk NO*.[49] In that case it was held that a judgment against the principal debtor had not created a new debt. Accordingly, the court held that the plaintiff had to rely on the original principal debt and that since that principal debt was void, the surety was entitled to rely on such invalidity as a defence.

- **As a general rule, any defence that the principal debtor could raise against the creditor could also be raised by the surety against the creditor**: The exception to this is where the principal debtor has a defence that is available only to him or her personally. Not all personal defences that are available to the principal debtor are available to the surety, for example minority, lunacy, and duress. All other defences are available to the surety, for example misrepresentation, illegality, and impossibility.[50]

  This situation may create a paradox where the principal debtor is an unassisted minor whose personal defence will be his or her lack of contractual capacity, which will make the contract void. The creditor still could sue the surety for the minor's debt. In this way, a creditor still could get payment from the surety in respect of the ancillary contract, even though the principal contract was void!
- **The principal debt may be any debt**: The debt may arise through any branch of law, not just contract law. The debt also may be a conditional one, in the form of positive or negative obligations.[51]

- **The principal debt need not be in existence at the time of contracting**: A valid contract of suretyship may be entered into in respect of any debt that may arise in the future. The principal debtor may not yet exist at the time the suretyship is entered into.[52]

  The rights against the principal debtor and the rights against the surety may be in different hands:[53] It is possible for the creditor to have ceded to another person his or her rights under the principal obligation or the suretyship contract.

3.5 Types of surety

- **Ordinary surety**: This surety's liability is co-extensive with (that is, to the same extent as) that of the principal debtor to the creditor. The liability of the ordinary surety depends on the default of the principal debtor, and can only be enforced by the creditor when this default occurs.[54]
- **Co-sureties**: Two or more persons can undertake liability as a surety on behalf of the same principal debtor regarding the same principal debt.[55]

  For two sureties to be co-sureties, their liability must be co-extensive. Therefore, a surety who guarantees a fixed portion of the debt is not a co-surety with someone who has guaranteed a separate portion, or someone who has guaranteed the whole debt. Similarly, where there are two co-debtors, and one surety binds himself or herself on behalf of one debtor, and another surety binds himself or herself on behalf of the other debtor, the two sureties are not co-sureties.

  Where a co-debtor is liable jointly, the surety, on behalf of a co-debtor, is liable only to the extent of the co-debtor's proportionate share of the liability. Similarly, where the co-debtor is liable severally, the surety will be liable for the whole debt.
- **Continuing surety**: Sureties may guarantee the payment of a particular amount or payment arising from several or continuous transactions. This continuing guarantee may operate indefinitely. The surety undertakes to pay the balance on the account at the time the principal debtor fails to pay. The guarantee may be limited in time, limited to a certain amount, or unlimited. If unlimited, it may be cancelled by giving the creditor

reasonable notice. The court will decide on the limitations of the suretyship by looking at the suretyship document in each case.[56]

- **Surety on behalf of a surety**: A ‘rear-surety’ or *agterborg* is a person who acts as a surety for a surety. He or she is not a co-surety; but a surety for someone who is in turn a surety for another person. The rear-surety has a right of recourse against the principal surety if he or she is required to pay due to the principal surety's default. The creditor first must take action against the principal debtor, then the principal surety, and only then may action be taken against the rear-surety. The rear-surety will have no right of recourse against the principal debtor unless he or she takes cession of action from the creditor.
- **Surety for reward**: It is possible for a surety to be paid by either the debtor or the creditor in exchange for accepting the suretyship. The liability of the surety to perform will be suspended and made dependent on payment being received.
- **Surety on a bill of exchange**: An *aval* is a stranger to a bill of exchange who binds himself or herself as surety to guarantee payment of the bill by one or more of the parties who are liable on it.
- **Joint surety**: A joint surety binds himself or herself to his or her proportionate share of the debt, together with other sureties. Unless otherwise specified in the written suretyship contract, they are deemed to be jointly and severally liable with each other.[57]
- **Surety and co-principal debtor**: The surety binds himself or herself as a co-principal debtor. He or she does not undertake the principal obligation, but waives the benefits of excussion and division.[58] These two concepts are discussed below in section 3.7.3 of this chapter.

3.6 Methods for the surety to limit personal liability

A surety may limit personal liability by:

- Requiring security from the principal debtor, for example a mortgage bond.
- Requiring an *agterborg*.
- Imposing conditions in the suretyship contract, for example a resolutive condition that requires the debtor to notify the surety in writing on the

debtor's default. If this notice is not given, the surety will be released from any suretyship obligations.
- Limiting the maximum amount for which he or she may be liable.
- Limiting his or her liability to a specified obligation.
- Limiting his or her liability to the amount owed by a particular date.
- Terminating the suretyship contract after a fixed time period.
- Requiring another person to be a co-surety.

3.7 Rights of the surety

Once the debt is due, the creditor may sue either the principal debtor or the surety for payment. There is normally no obligation to proceed first against the principal debtor.[59]

Generally, when sued by the creditor, the surety has available to him or her all the defences that would be available to the principal debtor. These are known as ‘real defences’. The exception to this, however, are ‘personal defences’. These are available to the debtor only and may not be used by the surety. For example, if the debtor is a minor or insolvent.

3.7.1 The right of recourse against the principal debtor

As soon as the surety (or co-surety) has paid the debt, he or she immediately has a right of recourse against the principal debtor. The surety may recover the amount he or she paid, as well as any damage, loss, or expense incurred by him or her as a direct result of the debtor not having met his or her obligations, including interest payable to the creditor.

The right of the surety to recover is dependent on him or her having paid the debt to the creditor. Payment must have been valid, that is, the surety must have paid the correct creditor. The surety must not have failed to establish a defence, or a defence available to the debtor. The surety must inform the debtor that he or she has paid the creditor.

There are a few situations where the surety may recover from the principal debtor, without the surety having paid the debt to the creditor:

- Where a court judgment has been obtained against the surety, the surety is entitled to recover the full amount from the debtor immediately, even

though he or she may not yet have paid the debt himself or herself.[60]

- Where the debtor and surety have agreed that the debtor will receive the surety's discharge within a certain time or pay the debt when the surety is called upon to pay it.
- Where the principal debtor is wasting his or her assets in a way that causes the surety alarm.
- Where there is an agreement between the surety and the creditor by which the debtor's debt is released.[61]

3.7.2 The right of contribution from co-sureties

Two or more sureties, who are sureties for the same principal debtor in respect of the same obligation, are ‘co-sureties’ even if they have given their guarantees by separate instruments or in separate documents, or independently of each other, or at different times, or if they are not known to each other. Sureties who each guarantee only a portion of the debt are not co-sureties.

The basis of the right to contribution from a co-surety is that, by payment of the debt, the co-surety has relieved the other co-sureties of their liability, and they have been enriched at his or her expense. A co-surety does not require a cession of action to proceed against another co-surety.[62] Another co-surety may be sued only for his or her proportionate share of the debt, not the entire debt.[63]

Gerber v Wolson [64]

Seven people signed a suretyship document as joint and several sureties and co-principal debtors, having renounced the benefits of excussion and division. One of them paid the whole amount due, and received a cession from the creditor of all rights under the suretyship document. He then sued one of the other sureties for six-sevenths of the amount, and tendered cession of the rights under the document.

The court held that the other surety was liable for only one-seventh of the amount.

3.7.3 The three special defences against the creditor

These defences are known also as ‘benefits’.

3.7.3.1 The benefit of excussion

Where the creditor first proceeds against the surety, the surety may claim the ‘benefit of excussion’.This means that the creditor should first proceed against the principal debtor before claiming from the surety.

This forces the creditor to obtain a judgment first against the principal debtor and proceed with execution against his or her goods. Where the creditor is forced to do this, and the execution is unsuccessful, the surety will be liable for the creditor's costs.

The benefit of excussion is not available to the surety if:

- The surety has renounced the benefit implicitly, or renounced it explicitly by signing the agreement as ‘surety and co-principal debtor’.[65]
- The principal debtor's estate has been sequestrated.
- The principal debtor is insolvent.[66]
- The principal debtor is manifestly unable to pay.
- The principal debtor is outside South Africa and has no attachable assets in this country.
- The principal debtor has a personal defence not available to the surety.
- The benefit of excussion has been waived, either explicitly or implicitly. An example of the latter is if there was a failure to raise the benefit immediately on the commencement of litigation. Most suretyship contracts contain clauses specifically excluding the benefit of excussion.
- The surety hinders the creditor in proceeding against the debtor.

3.7.3.2 The benefit of division

The ‘benefit of division’ defence applies where there are two or more sureties for a single debt of the principal debtor. The effect is to allow one co-surety to pay only his or her proportionate share of the total liability; the balance is shared by the other co-sureties.

Co-sureties are liable jointly and severally on the suretyship, that is, they are liable both as a group and individually for the full amount of the suretyship debt. Where one co-surety is sued for the whole amount, he or she may claim the benefit of division, that is, that the claim be divided proportionately between himself or herself and all the other sureties who are solvent and able to pay. The co-surety should be liable only for his or her proportionate share of the debt. Therefore, the co-surety is able to restrict the creditor's claim against him or her to a proportion of the total debt. However, most suretyship contracts contain a clause renouncing the benefit of division.

The benefit may be lost if:

- The co-surety has implicitly renounced the benefit, or explicitly renounced it by signing as ‘co-surety and co-principal debtor’.[67]
- The co-surety explicitly waives his or her right to the benefit.
- The co-surety implicitly waives the benefit, for example by suing for the entire amount and failing to claim the benefit of division.

- The co-surety is outside South Africa and cannot be found.
- The co-surety is insolvent before the commencement of proceedings.

3.7.3.3 The benefit of cession of action

The 'benefit of cession of action' defence is available to a surety who has already paid according to his or her suretyship obligation. He or she is entitled to a cession of action from the creditor, entitling him or her to recourse against the principal debtor and the other sureties.[68]

Other advantages of cession of action for the surety are:

- The surety can claim interest and other costs.
- The surety can use any security that the principal creditor had.
- The surety may be able to recover from third parties, for example partners.

Even where the benefit has been renounced, the creditor is entitled to a cession of action. The only effect of the renunciation is to prevent the surety from delaying payment.

Where several sureties are called on to pay a portion of the obligation, each one is entitled to cession of a portion of the debt. This cession does not require consent from the debtor.[69]

3.8 Termination of the suretyship contract

A contract of suretyship will terminate as follows:[70]

- **Termination of the principal debt**: Ordinary rules for termination of contracts apply. As soon as the principal debtor's obligation is ended, the suretyship is terminated, for example payment by the principal debtor.

  Part-payment does not relieve the surety. Novation or delegation of the principal debt both discharge the surety, unless he or she agrees to the new or transferred obligation.

  If the principal debt is extinguished by prescription, the suretyship obligation is also extinguished by prescription.[71]

Jans v Nedcor Bank Ltd [72]

The court considered whether interruption of prescription in relation to a co-principal debtor *in solidum* interrupts prescription as against all other co-principal debtors *in solidum*. This approach would result in hardship to sureties.

The court held that a surety voluntarily assumed an obligation in relation to another's debt. By simply being vigilant a surety could avoid the situation where prescription as against the principal debtor could be interrupted without the surety's knowledge. It would be anomalous for a surety voluntarily to assume an obligation, fail to exercise vigilance and then expect the law to protect him or her. Convenience and fairness favoured the approach that interruption of prescription in relation to a principal debtor resulted in interruption of prescription in relation to a surety.

- **Expiry of fixed time period**: A surety who binds himself or herself for a limited period of time will be responsible for debts incurred during that period of time only. A creditor will be able to sue the surety only on a debt incurred during that fixed time period. Also, because of the law relating to prescription, the surety can be sued only if the creditor commences the action within three years of the date the debt was incurred.
- **Continuing suretyship**: In the absence of a clause to the contrary, the surety may terminate future liability under a continuing suretyship by giving reasonable notice to the creditor.[73]
- **The creditor's conduct is prejudicial to the surety**: Any of the following could result in the termination of the suretyship contract, if done without the surety's consent:
  - A material change to the principal obligation: The surety will be released if the creditor agrees, without the surety's consent, to a material alteration to the principal debtor's obligations. It would be a material alteration if the surety would not have contracted under those provisions.[74]
  - Payment to the debtor of any retention money.[75]
  - Allowing the debtor to not keep to the terms of a contract; this results in increased risk to the surety.[76]
  - Refusal to accept performance from a debtor who later becomes insolvent.[77]
  - Money loaned in excess of amount guaranteed in violation of condition in suretyship that this should not be done.[78]
  - Failure to take securities that should have been taken.[79]
  - Release of securities that should have been retained.[80]

- Release of a co-surety or a co-debtor.

Extensions of time granted by the creditor to the principal debtor may be prejudicial when performance is not yet due, or when the surety is released. Where the debtor is already late with performance, extensions will not release the surety unless this amounts to a novation.

- **Discharge by operation of law**: The set-off by the principal debtor of a debt owed to him or her by the creditor will also release the surety. Similarly, merger releases the surety. If the principal debt is extinguished by prescription, the suretyship obligation is also extinguished by prescription.

4 Personal and real securities compared

A security ensures performance of an obligation to pay a debt. The differences between different forms of personal and real securities are illustrated in Table 20.2.

Table 20.2 *Personal securities and real securities compared*

	Personal security	**Real security**		
Name	Suretyship.	Mortgage.	Pledge.	Lien.
Type of right	A personal right against a person.	A real right over a thing.	A real right over a thing.	A real right over a thing.
Definition	An accessory contract by which the surety agrees to pay, jointly and severally with the principal debtor, the whole or part of an obligation due to the creditor.	A contract between a debtor and a creditor that immovable property may be sold to make good any part of the debtor's obligation to pay the creditor.	A contract between a debtor and a creditor that movable property, or an incorporeal, may be placed in possession of the creditor and sold to make good any part of the debtor's obligation to pay the creditor.	A contract between a debtor and a creditor in which a right is given to the creditor in possession of the debtor's movable property to retain it until the creditor is refunded for expenditure incurred. If incurred by consent, this is a debtor and creditor lien. If without consent, it is an enrichment lien.
Example when it may be used	Payment for tuition.	Payment for a house.	Payment for equipment.	Payment of car repairs.
Requirements	Agreement written and signed by or on behalf of the surety.	Agreement written and signed by or on behalf of the mortgagee, and registered against the title deeds of the immovable property.	Agreement can be written or oral. Actual or constructive delivery of the incorporeal or corporeal, and physical control of the movable.	Intention to retain physical control and possession of the movable.
Amount	Limited to the same or less than the principal obligation.	Limited to the same or less than the value of the asset. Surplus of	Limited to the same or less than the value of the asset. Surplus of	Limited to the same or less than the amount of the expenditure. Surplus of proceeds, if any, revert to the debtor.

		proceeds, if any, revert to the debtor.	proceeds, if any, revert to the debtor.	
Termination	On termination of the principal obligation, or expiry of the stated time period.	On cancellation and deregistration.	On payment of the debt, or loss of possession.	On payment of the debt, or loss of possession.
Notarial bond: Similar characteristics to both a mortgage and a pledge. A written and signed agreement in respect of movable assets and registered. No actual delivery is required. No real right is created; only a preference on insolvency.				
Kustingbrief: A special mortgage over immovable property. The buyer is allowed to retain part of the price.				

PRACTICALLY SPEAKING

Securing a loan for your business

Most businesses commence with the aid of a loan. Shopping around for a loan will assist in getting the best financing deal. Security for the loan will generally be required. This can be in the form of a mortgage over the land or building, a notarial bond over the equipment, or a suretyship signed by someone else who will pay the lender if you fail to do so. As a general warning, always be extremely cautious before signing as surety for someone else's debt. If that person defaults on the debt, the creditor will turn to the surety for payment.

Life insurance may be a requirement in case you die before paying off the loan. When you are required to provide security for a loan:

- Research current interest rates. Use the internet, or call at least six lenders for information.
- It is usually cheaper to take out a mortgage on your own home, than to obtain a new bank loan.
- Negotiate. Ask the lender if they would offer the loan at a lower rate of interest.
- Ask for details on the same loan amount, loan term, and type of loan from multiple lenders so that you can compare the information. Be sure to take into account the broker fees and other credit charges.
- Ask whether the rate is fixed or variable. An increase of several percentage points might raise payments by hundreds of rand per month.
- If a loan has a variable rate, ask when and how the rate and loan payment could change.
- Find out how much the lender will finance. Some lenders will finance 100% of the costs of the new business or stock, others may only offer a loan for a percentage. Ask

if there is insurance required to secure the loan, and work out how much that will cost.
- Ask if you can pay off the loan early and if there is a penalty for doing so.
- Find out if there are penalties if you default on any payments.

THIS CHAPTER IN ESSENCE

1. A real security gives the creditor a real right to an asset. Real security exists over a particular asset belonging to a debtor that is earmarked for the satisfaction of the creditor's claim.
2. Personal security refers to the situation where a person other than the debtor holds himself or herself liable for the debt.
3. A right of security, whether real or personal, is accessory to the obligation it secures. If the principal obligation is void, or is subsequently terminated, then the right of security may similarly be void or unenforceable.
4. A mortgage is the real right of one person called the mortgagee (or bondholder) over the property of another person, the mortgagor (or debtor), as security for the payment of a debt. The property must be in the form of an immovable asset or assets.
5. A *kustingbrief* and a notarial bond are two forms of special mortgages.
6. A pledge is a contract by which a debtor (pledgor) places movable property in the hands of a creditor (pledgee) as a real right of security for a debt.
7. A lien is a real right of retention arising from the fact that one person has put money or money's worth into the property of another.
8. ‘Suretyship’ is a form of personal security given by a debtor to a creditor in terms of which a third person undertakes to perform the obligations of the debtor if the debtor fails to do so.
9. The three special defences a surety may have when being sued by a creditor are known also as benefits: the benefit of excussion; the benefit of division; and the benefit of cession of action.

QUESTIONS

Short questions (1–5 marks)

1. List the three requirements that real securities must satisfy.
2. List ten ways in which a mortgage may be terminated.

3. Define a notarial bond.
4. Define a pledge.
5. Define a lien.
6. List two ways in which a lien may be terminated.
7. What is a *kustingbrief*?
8. Define a contract of mortgage.
9. Define suretyship.
10. List the four ways in which suretyship may be terminated.

Paragraph questions (5 marks)

1. Discuss the ways that suretyship may be terminated.
2. Write notes on liens and pledges.
3. Distinguish between the following liens:
    a. Debtor and creditor liens.
    b. Improvement liens.
    c. Enrichment liens.
    d. Salvage liens.
4. Discuss in detail the requirements for the existence of a valid lien:
    a. Legal possession.
    b. Uninterrupted possession.
5. Discuss the rights of the surety.

Essay questions (10 marks)

1. Explain what suretyship is and how it functions.
2. Discuss the various defences and benefits available to a surety who is being sued on the suretyship agreement.

Problem question (20 marks)

1. Michael agrees to pay R100 000 to his wife, Nancy. Michael's parents, Geoff and Harriet, sign as co-sureties in respect of R60 000 of the debt, while Michael's brother, Fred, agrees to be surety and co-principal debtor for the full R100 000, but only for a period of 12 months. Michael's sister, Ethel, enters into a verbal agreement to be a surety for Fred. Discuss, in legal terms, each of the transactions. What advice would you give to each of the parties in the following circumstances:

a. Michael is only 17 years old.
b. Geoff is an unrehabilitated insolvent.
c. Michael dies before he repays the loan.
d. Michael defaults on the loan and the bank decides to sue only Ethel.
e. After two years, the bank sues each of the parties.

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1 Fouché, 277; Sharrock, 567–568.

2 Gibson, 551–560; Havenga et al., 280–283.

3 Fouché, 279–280; Gibson, 556–560; Havenga et al., 281–282; Sharrock, 568–574.

4 Deeds Registries Act 47 of 1937.

5 Kahn, *Contract and Mercantile Law through the Cases Vol 2*, 862.

6 Sharrock, 573–574.

7 Section 102 of the Deeds Registry Act 47 of 1937.

8 *Ikea Trading und Design AG v BOE Bank Ltd* 2005 (2) SA 7 (SCA).

9 Security by Means of Movable Property Act 57 of 1993.

10 *Smith v Farrelly's Trustee* 1904 TS 949; Fouché, 280; Gibson, 555; Havenga et al., 280–281; Sharrock, 574.

11 *Smith v Farrelly's Trustee* 1904 TS 949.

12 Security by Means of Movable Property Act 57 of 1993.

13 Ibid.

14 *Leyds NO v Noord-Westelike Kooperatiewe Landboumaatskappy Bpk* 1985 (2) SA 769 (A); *Bank of Lisbon and South Africa Ltd v The Master* 1987 (1) SA 276 (A); *Incledon (Welkom) (Pty) Ltd v QwaQwa Development Corporation Ltd* 1990 (4) SA 798 (A); *Land- en Landboubank van Suid-Afrika v Die Meester* 1991 (2) SA 761 (A).

15 *Lief NO v Dettmann* 1964 (2) SA 252 (A); *Trust Bank of Africa Ltd v Standard Bank of SA Ltd* 1968 (3) SA 166 (A).

16 *Graf v Buechel* 2003 (4) SA 378 (SCA).

17 Ibid.

18 Gibson, 552–555; Havenga et al., 282–283; Kahn, *Contract and Mercantile Law through the Cases Vol 2*, 913; Sharrock, 589–592.

19 *Marinus v Taljaard* 1952 (1) SA 49 (C).

20 *Donaldson v Estate Veleris* 1938 TPD 269.

21 *Brooklyn House Furnishers (Pty) Ltd v Knoetze and Sons* 1970 (3) SA 264 (A).

22 Gibson, 554.

23 *General Garage v Plough Hotel* 1961 (3) SA 449 (N); *Van Niekerk v Van den Berg* 1965 (2) SA 525 (A).

24 *Van Niekerk v Van den Berg* 1965 (2) SA 525 (A).

25 *Singh v Santam Insurance Ltd* 1997 (1) SA 291 (A).

26 *Business Aviation Corporation (Pty) Ltd and another v Rand Airport Holdings (Pty) Ltd* [2007] 1 All SA 421 (SCA).

27 *Sandton Square Finance (Pty) Ltd and others v Vigliotti and another* 1997 (1) SA 826 (W).

28 *Marinus v Taljaard* 1952 (1) SA 49 (C).

29 *BOE Bank Ltd v Van Zyl* 2002 (5) SA 165 (C).

30 *Arend and another v Astra Furnitures (Pty) Ltd* 1974 (1) SA 298 (C) at 306A–B.

31 *Milne v Cook* 1956 (3) SA 317 (N); *Television and Electrical Distributors (Pty) Ltd v Coetzer* 1962 (1) SA 747 (T); *Sapirstein v Anglo African Shipping Co (SA) Ltd* 1978 (4) SA 1 (A).

32 *Orkin Lingerie Company Ltd v Melamed and Hurwitz* 1963 (1) SA (W); *Trust Bank of Africa Ltd v Frysch* 1977 (3) SA 562 (A); Gibson, 548–551; Havenga et al., 277–280; Sharrock, 578.

33 Sharrock, 578.

34 *Hutchinson v Hylton Holdings and another* 1993 (2) 405 (T).

35 General Law Amendment Act 50 of 1956.

36 *Nelson v Hodgetts Timbers (East London) (Pty) Ltd* 1973 (3) SA 37 (A).

37 *Inventive Labour Structuring (Pty) Ltd v Corfe* 2006 (3) SA 107 (SCA).

38 *Sapirstein v Anglo African Shipping Co (SA) Ltd* 1978 (4) SA 1 (A).

39 *Inventive Labour Structuring (Pty) Ltd v Corfe* 2006 (3) SA 107 (SCA).

40 Section 6 of the General Law Amendment Act 50 of 1956.

41 *Brink v Humphries and Jewell (Pty) Ltd* 2005 (2) SA 419 (SCA).

42 *Sapirstein v Anglo African Shipping Co (SA) Ltd* 1978 (4) SA 1 (A).

43 *Pizani v First Consolidated Holdings (Pty) Ltd* 1979 (1) SA 69 (A).

44 *Nedbank Ltd v Wizard Holdings (Pty) Ltd and others* 2010 (5) SA 523 (GSJ).

45 Matrimonial Property Act 88 of 1984.

46 *Wiehan NO v Woude* 1957 (4) SA 4 (W).

47 *Metequity Ltd NO and another v Heel* 1997 (3) SA 432 (W).

48 Companies Act 61 of 1973.

49 *Swadif (Pty) Ltd v Dyk NO* 1978 (A) (1) SA 928 AD.

50 *Worthington v Wilson* 1918 TPD 104.

51 *Corrans v Transvaal Government* 1909 TS 623; *Segell v Kerdia Investments (Pty) Ltd* 1953 (1) SA 20 (W).

52 *United Dominians Corporation (SA) Ltd v Rokebrand* 1963 (4) SA 411 (T).

53 *Inter-Union Finance Ltd v Dunsterville* 1956 (4) SA 280 (N).

54 *Wood Brothers v Gardner* (1886) 5 EDC 189 at 191; *Moreriane v Trans-Oranje Finansierings Ontwikkelings Korporasie Bpk* 1965 (1) SA 767 (T).

55 *Kalil v Standard Bank of SA Ltd* 1967 (4) SA 550 (A); *Nelson v Hodgetts Timbers (East London) (Pty) Ltd* 1973 (3) SA 37 (A).

56 *Glenn Brothers v Commercial General Agency Company Ltd* 1905 TS 737.

57 *Manufacturers Development Co (Pty) Ltd v Repcar Holdings (Pty) Ltd* 1975 (2) SA 779 (W).

58 *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron* 1978 (1) SA 463 (A).

59 *Hurley v Marais* (1882) 2 SC 155.

60 *Van der Walt's Trustees v Van Coller* 1911 TPD 1173.

61 *Rutowitz's Flour Mills v The Master* 1934 TPD 163; *Turkstra v Massyn* 1959 (1) SA 40 (T).

62 *Kroon v Enschede* 1909 TS 374.

63 *Gerber v Wolson* 1955 (1) SA 158 (A).

64 Ibid.

65 *Business Buying and Investment Co Ltd v Linaae* 1959 (3) SA 93 (T); *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron* 1978 (1) SA 463 (A).

66 *Lange Accessories (Pvt) Ltd v Fisher* 1974 (1) SA 61 (R); *Shell SA (Pty) Ltd v Guarantee Exchange International* 1986 (4) SA 7 (C).

67 *Neon and Cold Cathode Illuminations (Pty) Ltd v Ephron* 1978 (1) SA 463 (A).

68 *African Guarantee and Indemnity Company Ltd v Thorpe* 1933 AD 330; *Gerber v Wolson* 1955 (1) SA 158 (A).

69 *Millers Trust Foreshore Properties (Pty) Ltd v Kasimov* 1960 (4) SA 953 (C).

70 Gibson, 550–551; Havenga et al., 278; Sharrock, 587–589.

71 *Incorporated General Insurances Ltd v Saayman* 1982 (1) SA 739 (T); *Jans v Nedcor Bank Ltd* [2003] 2 All SA 11 (SCA).

72 *Jans v Nedcor Bank Ltd* [2003] 2 All SA 11 (SCA).

73 *Tsaperis and others v Boland Bank Ltd* 1996 (1) SA 719 (A).

74 *Nathanson v Dennil* 1904 TH 289; *Minister of Community Development v SA Mutual Fire and General Insurance Co Ltd* 1978 (1) SA 1020 (W); *Lategan NNO v Boyes* 1980 (4) SA 191 (T).

75 *Nathanson v Dennil* 1904 TH 289.

76 *Larkins and Green v Bork* 1886 (2) SAR 108.

77 *St Patricks Mansions (Pty) Ltd v Grange Restaurant (Pty) Ltd* 1949 (4) SA 57 (W).

78 *Standard Bank of South Africa Ltd v Cohen* (2) 1993 (3) SA 854 (SE).

79 *Business Buying and Investment Co Ltd v Linaae* 1959 (3) SA 93 (T).

80 *Wassenaar v SA Scottish Finance Corporation Ltd* 1961 (4) SA 526 (T); *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W).

Chapter 21

Negotiable instruments and other forms of payment

'A bank is a place that will lend you money if you can prove that you don't need it.'

BOB HOPE (1903–2003)
BRITISH-BORN AMERICAN COMEDIAN AND ACTOR

What is covered in this chapter

1 What is a negotiable instrument?
2 Characteristics of a negotiable instrument
3 Parties to a cheque and terminology
4 Essential elements of a cheque
5 The holder and the true owner
6 Characteristics of a cheque
7 Indorsement of cheques
8 Crossing a cheque
9 Marking on a cheque
10 Liability on a cheque
11 Protections provided to banks
12 Bank certified cheques
13 Bank guaranteed cheques
14 The cambial obligation
15 Liability on a cheque

16 True owner's rights of recovery
17 Liability of the bank
18 Other forms of payment
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Hundreds of years ago, traders carried goods to swop. Large amounts of goods were paid for using coins and money. However, to pay for a lot of goods with a large amount of coins and stacks of paper money was obviously very difficult. Also, it was dangerous to carry large amounts of money because of thieves. For these reasons it became necessary for traders to develop a new system of payment in which a single piece of paper could represent the full value of a large amount of coins and stacks of money.

A ‘negotiable instrument’ is a document that entitles someone to an amount of money. Anyone who possesses the document can claim payment. This person is called the ‘holder’. The document can be handed to another person, or even posted. Because the right to payment is contained in the document, the right to payment is easily and safely transferable from one person to another. This mercantile system of payment was recognised by the courts of Europe, and made its way into South African law. The most well-known negotiable instrument we use today is a cheque. However, there are other types as well.

In South Africa, the law of negotiable instruments is governed by the Bills of Exchange Act.[1] In modern times, additional new ways have been devised to effect payment. These include traveller's cheques, credit cards, letters of credit, stop orders, debit orders, and electronic transmissions of funds.

1 What is a negotiable instrument?

The Bills of Exchange Act deals with negotiable instruments, which include bills of exchange, cheques and promissory notes. A negotiable instrument is a document that contains a promise that the person in possession of the document (the holder) will be paid a specified amount of money.

A negotiable instrument is a very special kind of document. It represents both a payment, and also an underlying legal contract. For example, one can purchase a motor vehicle, and pay by cheque. The principles of the law of contract will apply to the contract of sale, and the law of negotiable instruments will apply to the cheque. In effect, this means that if payment is not made, the seller can choose to sue the buyer for payment either on the contract or on the cheque.

A cheque is a negotiable instrument that makes an unconditional written order to a bank. It is signed by a customer of the bank (the drawer). It instructs the bank to pay a specified amount of money to the bearer of the cheque, or to the person specified on the cheque (the payee) or to someone nominated by that specified person.

The Act governs bills of exchange, cheques, and promissory notes, and defines them as follows:[2]

- **Bill of exchange**: An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable time, a sum in money to a specified person, or to that person's order, or to bearer.
- **Cheque**: An unconditional order in writing, addressed by a person to a banker, signed by the former, requiring the banker to pay on demand a sum certain in money to a specified person, or to that person's order, or to bearer.
- **Promissory note**: An unconditional promise in writing made by one person to another, signed by the maker, and engaging to pay on demand,

or at a fixed or determinable future time, a sum certain in money, to a specified person, or to that person's order, or to bearer. The promissory note must actually make a promise to pay, and not merely acknowledge indebtedness.

This book will concentrate only on cheques.

2 Characteristics of a negotiable instrument

The two most important characteristics of a negotiable instrument are the following:[3]

- **Simplicity of transfer of title**: It must be really easy to make another person entitled to the payment promised in the document. If someone has ‘title’ to a negotiable instrument, this means that they are entitled to all the rights that are part of the document. For an instrument to be ‘negotiable,’ title must be capable of being transferred to another person both easily and informally. Where the instrument is made payable to ‘bearer’, this means that the promise to payment can be given to another person simply by the holder handing the document over. Where the instrument is made payable to ‘order’, this means that the promise to payment can be given to another person by the holder signing the back of the document and handing it over to that person. Signing the document in this way is called ‘indorsement’.
- **Transferability free from equities**: Generally no one can give a right to another person if they do not have that right themselves. For example, if a thief steals a car and sells it to you, the true owner will be able to go to court to recover the vehicle from you. The thief cannot sell you ownership of the car because he or she was never the owner.

  The law of negotiable instruments is different. In some cases, it is possible to pass on to another person more rights to the promise to payment in a negotiable instrument than you had yourself. If you receive a cheque, your rights are determined by whether or not you acted in good faith at the time, and whether or not you gave something of value in exchange. If so, you are regarded as a ‘holder in due course’ and you will be entitled to the promise of payment ‘free from equities’. This means that your rights to payment may be stronger than the rights of the person who transferred the cheque to you. In effect, you may be able to enforce payment on the cheque even if it had been stolen previously.[4]

3 Parties to a cheque and terminology

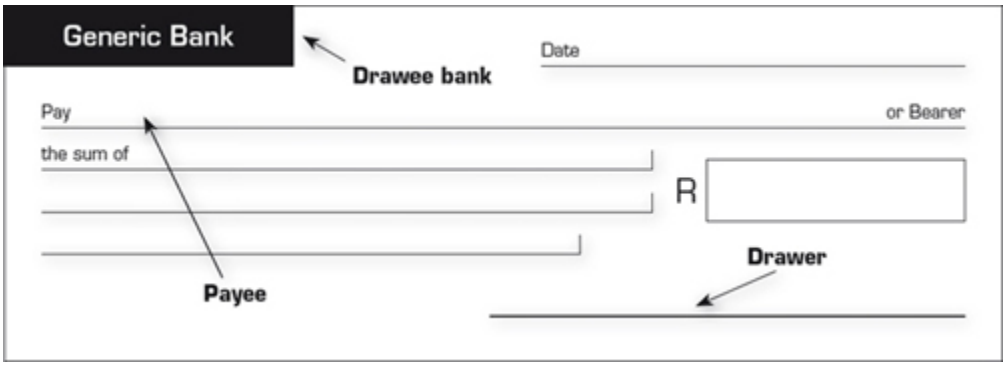

Figure 21.1 *Parties to a cheque and terminology*

If you operate a cheque account at a bank, the following terms will apply when you make out the cheque and hand it to someone else as payment:[5]

- You are the ‘drawer’. You have filled out the cheque and signed it. By doing this you are giving an instruction to your bank (the ‘drawee bank’) to make payment of the amount from your bank account.
- By writing out and signing the cheque you are ‘drawing’ an instrument.
- The person to whom the bank must make the payment is called the ‘payee’.
- The very first time that the drawer of a cheque gives it to someone entitled to payment is called the ‘issue’ of a cheque.
- If you make the cheque payable to yourself, the drawer and the payee will be the same person.
- A person entitled to payment may instead make someone else able to obtain payment on the cheque. This is done by a process called ‘indorsement’, which involves the former payee writing on the back of the cheque, signing the back of the cheque, and delivering it to the new payee. The former payee who is transferring the right to obtain payment to another person is called the ‘indorser’. The new payee is called the ‘indorsee’.
- ‘Negotiation’ is the transfer of the cheque in such a way as to make the transferee the ‘holder’.The holder is someone who is in possession of the cheque with certain rights to payment.

4 Essential elements of a cheque[6]

4.1 Unconditional order in writing

The cheque must direct only that money be paid, and no conditions may be attached. If anything else is ordered to be done, the cheque is conditional and therefore invalid. For example, the payment of money ‘on or before’ a specified date would make the cheque conditional, and therefore not fall into the category of a negotiable instrument.[7]

The language used must be direct and authoritative. For example, ‘Pay payee’. A request to pay someone does not meet the requirements of the definition of a negotiable instrument.

‘Writing’ includes printing or typing. In terms of section 3 of the Interpretation Act,[8] any reference to writing includes typewriting, lithography, photography, and all other methods of reproducing or representing words in a visible form. In the event of a conflict between any printed words, and any handwritten words, the words that are handwritten are deemed to represent the intention of the drawer.

Dependable Aluminium Windows and Doors CC v Antoniades[9]

A gambler convinced his friend to loan him money at a casino. The friend wrote a cheque to bearer, and deliberately inserted ‘R62 000’ in the space for figures, and ‘sixty two thousand cents’ in the space for words, expecting the cheque to be rejected. The casino did not reject the cheque, and paid out R62 000. The cheque was dishonoured at the bank and the drawer was sued.

The court held that the handwriting was so poor that it could not see the difference between the figures and the words. When viewed through the eyes of someone used to dealing in cheques, it was not likely that a cheque would be drawn for 62 000 cents, and so the words would be read as R62 000.

4.2 Addressed by one person to a bank

The drawer orders payment to be made by a bank to one person. The drawer may not order payment to be made either to one person or another person.

4.3 Signed by the person giving it

Any mark, stamp, or seal that is made with the intention of signing the cheque is taken to be a signature. It does not have to be written in ink and the signature does not have to appear in a specific place on the cheque.

A person who signs in a representative capacity should make it clear that he or she is signing on behalf of another, by adding one of the following to his or her signature: '*per procurationem*' or the abbreviation 'pp', 'for', 'on behalf of', 'per', or 'in the capacity of'.[10] A cheque not signed at all is invalid.

Van Tonder en andere v Vorster [11]

A man authorised his son to sign cheques on his behalf. The son had the same name as the father. The son signed the cheques and also wrote his name on the back of cheques.

The court held that the son had signed on behalf of the father in a representative capacity.

A signature is forged if the signer imitates the signature of another person with the intention to defraud. An 'unauthorised signature' is made on behalf of another person but without that person's authority, and usually without the intention to defraud. The principal may ratify the signature afterwards.

If a cheque is signed without authority, then the principal is not liable on it unless he or she ratifies the unauthorised signature. Where a person signs on behalf of a principal without actually having the authority to do so, that person will be liable personally. If the principal ratifies the unauthorised signature, the principal then assumes liability instead.

4.4 Payable on demand, or at a fixed or determinable future time

The date of payment must be stated or easily determinable from the face of the cheque. The cheque must be payable on the date of its presentation to the bank.[12] If the date of payment falls on a non-business day, then the cheque will be paid on the next business day.

A post-dated cheque is one that carries a date later than the date it was signed by the drawer. For example, you complete a cheque today that carries a date three days from now. In terms of section 11 of the Act, post-dated cheques are common and become valid on or after the post-date.[13] An

endorsee who comes into possession of a post-dated cheque before the due date may still be a holder in due course.

4.5 A sum certain in money

The amount to be paid must be a fixed amount. The cheque must order a particular amount of money to be paid, and the amount must be ascertainable from the face of the cheque. Normally the amount must be written in words and numbers. If the words and numbers do not correspond, then the words will prevail. However, in these cases the bank normally returns the cheque back to the drawer instead of paying.

4.6 To a specified person, to that person's order, or to bearer

4.6.1 Specified person

The identity of the payee must be easy to establish from the writing on the face of the cheque. There must be no words prohibiting transfer to another person. A cheque can be made payable to an office, such as ‘The City Treasurer’, or to two or more payees jointly, such as ‘Mr ABC and Ms XYZ’. The payee may be named in the alternative, such as ‘Mr ABC or Ms XYZ’.

Where a cheque is payable to a specified person, or to someone to whom that person may indorse it, it is called an ‘order’ instrument. An order instrument may be negotiated by indorsement and delivery.

A person whose name is wrongly spelt on the cheque may indorse it by using the misspelled name, and then adding his or her proper signature.

4.6.2 That person's order, or to bearer

Hundreds of years ago, cheques could not be transferred at all unless the document specifically allowed for this to happen. The words ‘or order’ were used for that purpose, and these words remain in use today. When a cheque is drawn in favour of a named person, such as ‘Pay Mr ABC’, it is the same as saying ‘Pay Mr ABC or order’. In other words, Mr ABC could claim payment himself, or indorse the cheque and the bank would be instructed to pay whoever it was that Mr ABC ordered them to pay instead.

Where the cheque is not payable to a specified person, or is indorsed only to bearer, it is called a ‘bearer’ instrument. The drawer simply makes the cheque payable ‘to order’, ‘bearer’ or to ‘cash’, or simply leaves the payee section blank. A bearer instrument may be negotiated by delivery only. In other words, it may be transferred validly by simply handing it over to another person.

Bank of England v Vagliano Brothers[14]

The court held that one must look at the intention of the drawer to establish whether the payee was fictitious or not. If the drawer had no intention to pay the payee, then the

payee was fictitious, whether the payee named in the bill existed or not. The instrument was therefore a bearer instrument.

A cheque marked ‘Pay cash only’ is not valid because there is no person called ‘cash’. However, a cheque marked ‘Pay cash or bearer’ is valid because the cheque is then a bearer instrument. The effect of cheques drawn to ‘cash only’ or to ‘order only’ is that these cheques are not valid bills of exchange because they do not specify a person to whose order the cheque is payable. These cheques are normally not paid or ‘dishonoured’ by bankers and returned with the answer ‘irregularly drawn’. The drawer should be requested to alter the cheque so that it is payable to ‘bearer’.

5 The holder and the true owner

The holder of a cheque must be distinguished from the true owner. The true owner generally is the person who will suffer loss as a result of the loss of the cheque. Normally, the payee will be the true owner if the cheque is lost after it has come into his or her possession. For example, if a cheque is stolen prior to delivery to the payee, the drawer will be the true owner.[15]

South African law distinguishes between four categories of holder:[16]

5.1 The holder

The holder of a bearer cheque is the person in possession of it. The holder of an order cheque is the payee (or the last indorsee if the cheque has been indorsed) who is in possession of it.

A holder has four rights:

- To negotiate the cheque.
- To sue on the cheque in his or her own name.
- To supplement deficiencies in the form of the cheque. For example, to add the date of issue or date of acceptance of the cheque.
- To obtain a duplicate of the lost cheque.

The major rights and powers of a holder are to sue on the cheque in his or her own name and to negotiate the cheque. Even if his or her title is defective, the holder may negotiate the cheque in such a way that the transferee becomes a holder in due course.[17]

A holder has three duties:

- To present the cheque for payment.
- To protest against the cheque being dishonoured. This is normally required in the case of a foreign cheque.
- To give notice of the cheque being dishonoured. A claim may then be made against the drawer or indorser(s) respectively, provided that notice of dishonour was given to them. However, notice of dishonour does not have to be given in the following cases: giving notice is impossible after

reasonable diligence; notice is waived; the drawer has cancelled payment of the cheque; or if the drawee is not bound to the drawer to pay the cheque. For example, where the bank dishonours the cheque because the drawer has insufficient funds in his or her bank account.

5.2 The holder for value

Giving value means that the cheque was not merely a gift. Where value has at any time been given for a cheque, the holder is deemed to be a holder for value.

5.3 The holder in due course

The Act[18] defines a holder in due course as a holder who has taken a cheque, complete and regular on the face of it; become the holder of it before it was overdue; and, if it had been previously dishonoured, did not have notice of it being dishonoured. He or she also must have taken the cheque in good faith and for value and, at the time the cheque was negotiated to him or her, must have had no notice of any defect in the title of the person who negotiated it.

Requirements for a person to be a holder in due course:

- **The person must be a holder**: This means he or she must be either the payee or indorsee in possession of an order cheque, or bearer in possession of a bearer cheque.
- **The cheque must be negotiated to that person**: To qualify, an order cheque requires indorsement and delivery. This means that the first payee of a cheque cannot be a holder in due course because the cheque was not negotiated to him or her: it was issued to him or her directly.[19] If the cheque is payable to bearer, then it is negotiated by delivery alone. The first issue of a bearer cheque is in itself a negotiation. The payee of a bearer cheque therefore may qualify as a holder in due course.[20]
- **The cheque must be regular and complete on the face of it**: If any essential element of form is missing when the holder takes it, he or she cannot be a holder in due course, even though a holder has the power to fill in any omission. However, provided he or she takes it when the cheque is complete and regular, he or she may be a holder in due course.

The cheque must not give rise to any suspicion. For example, if it was torn and glued together, or an alteration was unsigned. Any alterations must not change the legal liability of the parties even if they are signed.[21] There should be no discrepancy of amount between the words and the figures on the cheque. There should be no doubt that an indorsement is in fact an indorsement by the payee.[22] An indorsement is irregular when it gives rise to doubt as to whether it is the indorsement of the named payee, not merely because the signature is difficult to read.[23]

- **The person must take the cheque before it is overdue**: He or she must become the holder of a cheque before the cheque becomes stale, that is, prior to the date written on the cheque on which it is due for payment.
- **The person must take the cheque without any notice of it being previously dishonoured**: A bank will normally stamp a cheque if it refuses to pay on it. If someone has knowledge of a cheque being previously dishonoured, he or she is prevented from being a holder in due course.
- **The person must take the cheque in good faith and without notice of any defect in the title of the transferor**: He or she cannot hold the cheque to settle a debt arising from an illegal contract. The Act provides that the title of the transferor is defective if he or she obtained the cheque or accepted it through fraud, unlawful means, or for an illegal consideration.
- The Act also deems the title of the transferor to be defective if he or she negotiates the cheque in breach of faith or under circumstances that amount to fraud. Negligence does not amount to bad faith.[24] A thing is deemed to have been done in good faith when it is done honestly, whether negligently or not. If the holder had notice of any defect in title at the time the cheque was negotiated to him or her, he or she cannot be a holder in due course.
- **The person must take the cheque for value**: There must have been something given by him or her in exchange for the cheque. For example, he or she cannot be a holder in due course of a cheque given as a gift.

The holder in due course has all the rights and duties of an ordinary holder, and of a holder for value. In addition, the Act provides the holder in due course certain privileges not available to other holders. For example, once a

holder in due course takes transfer of a cheque a presumption is created that there has been a valid delivery of the cheque by all the parties previously. This presumption cannot be rebutted or disproved.

The holder in due course holds the cheque ‘free from equities’. This means that his or her rights are not affected by any defect in title of the person from whom the cheque was obtained. A holder in due course is protected against all relative defences relating to the obligation underlying the cheque. He or she acquires ownership in the cheque even when it was acquired from a non-owner, and obtains an indisputable right to claim payment.

A holder in due course may therefore enforce payment of the cheque against all parties liable on it previously. If the holder in due course sues a party for payment, only absolute defences based on the cheque itself may be raised. Absolute and relative defences are discussed later in this chapter.

5.4 The holder who derives title from a holder in due course

This is a holder, whether for value or not, who gets title through a holder in due course. If he or she is not personally a party to any fraud or illegality affecting the cheque, he or she has all the rights of a holder in due course.

6 Characteristics of a cheque[25]

6.1 Transferable

In principle, a cheque can be transferred from one person to another any number of times. This process is known as negotiation. Negotiation does not necessarily transfer ownership, or give the holder any rights to payment.

6.2 Holder may sue

The person to whom the cheque has been negotiated may sue for payment on it in his or her own name.

6.3 Instrument a source of obligations

The drawer of the cheque, and every person who has negotiated it, undertakes to make payment if the cheque is dishonoured by the bank. This is known as the cambial obligation. The cambial obligation is separate from that of the underlying contract that resulted in payment through the cheque.

Any defence that may be used by any person being sued on the underlying contract also may be used in defending a claim on the cheque, for example that the contract is void for illegality.

6.4 Good faith purchaser entitled to payment

A holder in due course is a person who, in good faith, has taken transfer of the cheque by negotiation, and given value for it. A holder in due course may claim a right to payment from the drawer and subsequent negotiators, even if the person who negotiated it to him or her had no title in the instrument, for example was a thief.

The law of negotiable instruments differs from the law of contract in that the holder in due course of a negotiable instrument is entitled to all the rights embodied in the instrument, regardless of the fact that the transferor may not have had any title to it. In the law of contract, no one can transfer to another a right greater than he or she has himself or herself. This is known as the *nemo plus iuris* rule.

The holder in due course also is entitled to greater rights than those given to an ordinary cessionary, who takes cession of action from a creditor in terms of the law of contract. Cheques are negotiated (not ceded), and a better title can be transferred if the new holder becomes a holder in due course. In the case of cession, the cessionary steps into the shoes of the cedent and all the defects in the title pass to the cessionary.

The whole idea is that the cheque can be transferred from one party to another, giving the holder the right to enforce payment on the instrument without having to be worried about why the document was originally drawn. As a result, a bona fide transferee for value can take the cheque and enforce it, even if there were defects of title, for example if it were originally obtained by theft or fraud. The advantage of negotiability is that much of the risk of acquiring a valuable document from a stranger is eliminated. The freedom of transferability, combined with the concept of negotiability, makes a negotiable instrument like a cheque a useful commercial device to make payment.

6.5 Payment in good faith discharges liability under the cheque

In the absence of any notice of defective title, payment to the holder will discharge the liability of the drawer and all subsequent negotiators.

Once the creditor accepts the cheque, he or she may not enforce the underlying debt until the cheque has been presented for payment and has been dishonoured. Once the bank pays, the underlying debt is deemed to have been discharged on the date the creditor received the cheque, and not on the date the bank made payment.[26]

7 Indorsement of cheques

Only an order cheque can validly be indorsed. A bearer cheque cannot be converted into an order cheque by a special indorsement, because the original instruction of the drawer was that payment should be made to the bearer. This means that neither the payee nor any subsequent holder will have the authority to change this instruction.

7.1 Requirements for valid indorsement of an order cheque

To be valid, the indorsement of an order cheque requires signature plus the intention to indorse and undertake the liabilities of an indorser. The signature does not need any additional words, and no date of indorsement needs to be written.

Where several undated indorsements are made on the back of the same cheque, it is presumed that they were made in the order of appearance. An indorsement must be for the whole amount on the cheque, and not just for some of the amount. Where the name of the indorser is incorrectly spelt, the payee must indorse the cheque with the incorrect spelling, and then sign it correctly. If a cheque is made payable to two or more payees, then they must all indorse it for the indorsement to be valid.

In circumstances where a bank requires the drawer of a cheque to sign the back of it to receive payment over the counter, the signature does not act as an indorsement. This is because it is not made with the intention to indorse, and also not made with the intention to assume the liabilities of an indorser. The signature merely acts as a receipt or identification of the person receiving payment.

7.2 Types of indorsement

There are three types of indorsement that can be made.

- **Blank indorsement**: The indorser signs the back of the cheque and does not indicate any indorsee to whom payment must be made. This converts

an order cheque into a bearer cheque, which can then be negotiated by delivery alone.

- **Special indorsement**: The indorser signs the back of an order cheque and writes a direction that a specific person or their order should be paid. For example, ‘Pay ABC’ or ‘Pay ABC or order’.
- **Restrictive indorsement**: The indorser signs the back of an order cheque and writes a direction affecting its negotiability. There are two types of restrictive indorsements: (1) An indorsement prohibiting further negotiation of the cheque. For example, ‘Pay ABC only’. The indorser intends to transfer the cheque to the indorsee, but further negotiation is prohibited; (2) An indorsement allowing the indorsee to deal with the cheque as directed, but does not allow owenership to pass. For example, where the payee writes ‘Pay ABC for the account of XYZ’ or ‘Pay ABC or order for collection’. In both cases the indorsee ABC is entitled to receive payment as a holder.

8 Crossing a cheque

Crossings provide protection againt loss resulting from cheques falling into the wrong hands. It is very common to cross cheques; some banks print cheques with crossings already on them.

The crossing on a cheque is an instruction to the drawee bank to pay the cheque only to another bank. In effect, this means that while an uncrossed cheque may be paid at the counter of the drawee bank, a crossed cheque must be paid into a bank account.[27]

The purpose of crossing a cheque is to make it more difficult for an unauthorised holder to receive payment. If the holder of a cheque wants to receive money for it, he or she will have to open a bank account, increasing the risk of detection of an unauthorised holder. The time taken for the cheque to be processed creates a window of opportunity for the drawer to learn of the loss of the cheque and to stop payment on it. However, a crossed cheque may still be negotiated to another person, and so crossing a cheque poses little deterrent to a dishonest person.[28]

Cheques may be crossed as follows:

8.1 General crossing

A generally crossed cheque is illustrated in Figure 21.2.

A generally crossed cheque can bear across its face any of the following:

- Two parallel transverse lines without any words between them.
- Two parallel transverse lines with the words ‘and company’ (or any abbreviation such as ‘Co’) between them.
- Two parallel transverse lines with the words ‘not negotiable’ between them.
- Two parallel transverse lines with the words ‘and company’ (or any abbreviation such as ‘& Co’) and the words ‘not negotiable’ added.

The words have no effect on the nature of the crossing. The effect of a general crossing is that the drawee bank pay the money only over to another

bank. This has the effect that the money cannot be paid out over the counter, but has to be paid into a bank account.

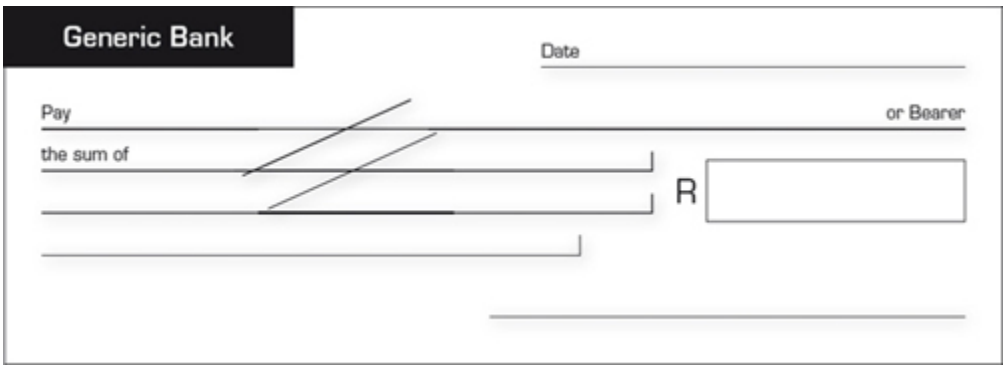

Figure 21.2 *Generally crossed cheque*

8.2 Special crossing

A specially crossed cheque bears across its face any of the following:

- The name of a specific bank.
- The name of a specific bank with two parallel transverse lines.
- The name of a specific bank with two parallel transverse lines and the words ‘not negotiable’ added.

The effect of a special crossing is that the drawee bank may pay the money only to the bank specified. The following parties may cross a cheque:

- The drawer, at the time of issue.
- The holder of an uncrossed cheque may cross it generally or specially.
- The holder of a cheque crossed generally may cross it specially.
- Where a cheque is crossed generally or specially, the holder may add the words ‘not negotiable’ or ‘and Co’.
- A cheque, crossed specially to a bank, may be crossed specially, in turn, by that bank to another bank for collection.
- Where an uncrossed cheque, or a cheque crossed generally, is sent to a bank for collection, that bank may cross it specially to itself.
- A bank, by using a teller's stamp or bank stamp on a cheque, may cross the cheque to that bank.

9 Marking on a cheque

A drawer or indorser of a cheque may add words that restrict or exclude the ability of a holder to negotiate it. These words are referred to as markings.[29] Cheques may be marked in five different ways.

9.1 ‘Account payee only’

This marking has no effect on the negotiability of a cheque. The words are simply a direction to the collecting bank as to what to do with the money. The words imply that the payee must be paid the money. The payee, however, may still indorse the cheque. By doing this, the payee indicates a willingness for another person to become payee. If the cheque is negotiated to another person, the words become irrelevant.[30]

9.2 ‘Only’

A cheque payable to a particular payee (for example ‘Pay C. Nkobo only’) only has the effect of making the cheque not transferable. The bank is not negligent if it ignores this marking.

9.3 ‘Not negotiable’

If the cheque is uncrossed, the effect of the words ‘not negotiable’ make the cheque non-transferable. However, if the cheque is crossed, then it is possible for it to be transferred, subject to the transferee also taking transfer of any defects in title. In effect, this means that such a cheque can in fact be negotiated, but the person who takes transfer of it does so subject to any defences that could have been raised against the person who gives the transfer. Please refer to Figure 21.3.

Where a crossed cheque bears the words ‘not negotiable’, a person taking the cheque does not have, and is incapable of giving, better title to the cheque than the person from whom it was taken. As a result, if the transferor himself or herself is not a holder in due course, the transferee will not be a holder in due course either.[31]

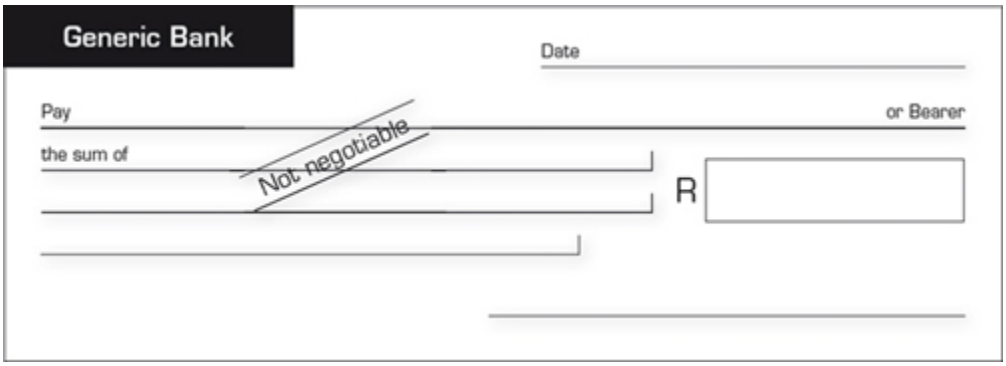

Figure 21.3 *Marking a cheque 'Not negotiable'*

9.4 'Not transferable'

By adding these words to the face of the cheque, the cheque becomes completely non-transferable. This means that no person other than the payee, or an immediate indorsee of the payee, may become a holder of the cheque.[32] The words may not be cancelled, and any purported cancellation is of no effect. Please refer to Figure 21.4.

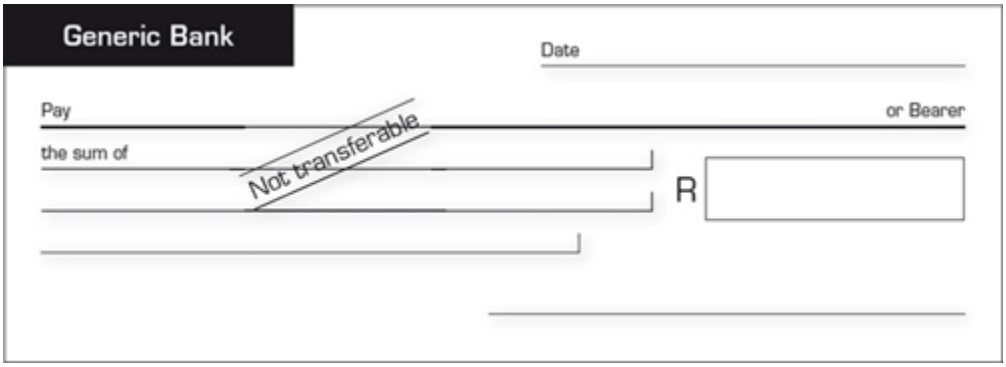

Figure 21.4 *Marking a cheque 'Not transferable'*

9.5 'For collection'

By instructing the bank to pay a certain payee 'for collection', the drawer simply appoints an agent to collect on behalf of the payee. This does not give the agent the right to negotiate the cheque further, and has the effect of rendering the cheque non-transferable.

10 Liability on a cheque

There are circumstances where the bank may refuse payment on a cheque, and circumstances where the bank must refuse payment.

10.1 The bank may refuse payment in certain circumstances

The bank may refuse to make the payment if the cheque does not comply with the necessary essential elements, or with the rules imposed by the bank. In the following cases, the bank may refuse payment of a cheque even though it is not required to do so:

- The cheque was not made out on one of the printed forms supplied by the bank.
- The cheque bears no date.
- The amount in words differs from the amount in numbers.
- The amount is expressed only in numbers.
- The date of a post-dated cheque has not yet arrived.
- The customer has no funds in his or her current account and no overdraft facility.
- The customer will exceed the limits of his or her overdraft if the cheque was to be honoured.
- The cheque is stale. Subject to the bank's internal policies, this occurs after the expiry of between three to six months after the date on which it was drawn.

> ***ABSA Bank Ltd v Blumberg and Wilkinson***[33]
>
> A firm of attorneys drew cheques against their trust account in the belief that other amounts would be deposited into that account. When this did not happen, they sued the bank for honouring the cheques, on the basis that they had no overdraft agreement with the bank.
>
> The court held that the absence of an overdraft agreement did not excuse customers of the bank from being liable to pay for the overdraft when they themselves had drawn the cheques.

A cheque may be dishonoured for any of the following reasons:

- **Lack of funds**: A cheque not paid for lack of funds usually is marked ‘refer to drawer’, indicating insufficient funds to meet the cheque.
- **Uncleared cheque**: These are usually marked ‘effects not cleared’, indicating that the bank first wishes to clear the cheque with its client before paying the amount.
- **Technical irregularities**: These include: alteration not signed by drawer; mutilation not confirmed by drawer; discrepancy between amounts in words and figures; unsigned cheque; a cheque made to order not indorsed or irregularly indorsed; or an incomplete cheque.

A customer whose cheque has been wrongly dishonoured may claim damages either for breach of contract or for defamation if the bank uses words that defame the customer. For example, ‘insufficient funds’ or ‘not provided for’.

10.2 The bank must refuse payment in certain circumstances

In the following circumstances the bank must refuse payment of the cheque because its mandate has been terminated:

- **Countermand of payment**: The client instructs the bank to stop payment on a cheque that is lost or stolen, or because of a dispute.
- **Notice of death of the client**: A cheque presented after the death of the client will be dishonoured with the words ‘drawer deceased’.
- **Notice of insolvency of the client**: A cheque will be dishonoured with the words ‘drawer's estate sequestrated’.

Where the bank is entitled to dishonour a cheque but does not do so, and makes payments in accordance with the instructions that have not been countermanded by the customer, the bank will be entitled to debit the customer's account with the amount of the payment.

Standard Bank of South Africa Ltd v Peens and others[34]

The bank was sued by customers after it had honoured cheques that had been fraudulently made and deposited.

The court held that the account holders had never countermanded payment of the cheques. Where the bank chooses to disregard fraud on a cheque, then in the absence of countermanding instructions the bank was entitled in its discretion to dishonour the

cheques. This entitlement did not mean that the bank was required to dishonour the cheques. The bank was accordingly entitled to honour the cheques and debit the accounts of the customers.

11 Protections provided to banks

11.1 Forged indorsements

Banks are protected by section 79 of the Act. Where a bank pays a crossed cheque in good faith and without negligence, and in accordance to the crossing, the bank is entitled to the same rights and will be placed in the same position as if payment of the cheque had been made to the true owner. This places the bank in the position of having paid the correct person and it may debit the customer's account, even though someone has been paid who should not have been. Therefore, the bank will be protected, and so will the drawer. The person to whom the money was truly owed only has an action against the person who has been unjustifiably enriched.[35]

Holzman v Standard Bank of South Africa Ltd [36]

An accountant forged signatures on several cheques. The bank claimed he was a risk that the employer ought to have known about, because he had been imprisoned before for theft and removed from the register of accountants. The employer had not known of the accountant's past.

The court held that carelessness in controlling access to a chequebook did not render a bank customer liable for the loss.

Section 79 also applies to crossed cheques that are marked ‘not transferable’. The drawee bank will be protected, even where it pays the cheque to another branch of the same bank. For this reason, if you are the drawer of a cheque it is always advisable to cross the cheque.

ABSA Bank Ltd v Greyvenstein[37]

A cheque was addressed to a specified payee ‘or order’ and marked ‘not transferable’. The respondent was the payee and gave the cheque to S to hold in trust and eventually to invest the proceeds. The cheque was deposited with the bank into the account of a close corporation (ICC) and had the respondent's signature as well as identity number on the reverse side. The cheque was accepted by the bank for collection and after it was met by the drawee the account of ICC was credited with the proceeds.

The respondent alleged that the bank had acted negligently against him as owner or payee or beneficiary of the cheque by collecting it for the account of ICC and that he had suffered damages in the amount of the cheque.

The court held that the words ‘not transferable’ meant that the cheque could not be transferred to another person in such a way as to constitute the transferee the holder.

This did not mean, however, that ownership in the cheque, as a corporeal movable property, could not be transferred. As the cheque had been delivered to S with the intention that it be held by him in trust and the proceeds invested, and as S had received it with the necessary intention, ownership had accordingly been transferred to him. After delivery of the cheque to S the respondent was no longer its owner. That was the position when the cheque was deposited with the bank for collection. The bank had thus not acted unlawfully against the respondent as he was no longer the owner of the cheque.

With uncrossed cheques, section 58 of the Act protects the bank if the following requirements are met:

- Payment must be made in good faith and in the ordinary course of business.
- The forged indorsement does not purport to be that of a customer of the bank at the branch on which the cheque is drawn.
- The indorsement must be intended to transfer rights to a subsequent holder.

11.2 Protection afforded the true owner

The words ‘not negotiable’ on a crossed cheque mean that the person taking it is not capable of giving better title to the cheque than the person from whom the cheque was taken.

The cheque can be negotiated, but the person taking it cannot become a holder in due course, even if it was negotiated in good faith and for value. Since there cannot be a holder in due course, the Act provides protection to the person who bears the loss of the cheque.

Section 81 operates where a crossed cheque marked ‘not negotiable’ has been lost or stolen and the drawee bank is protected by section 79. This section essentially does two things:

- It gives a right of recovery to anyone who has given consideration for the cheque or who has taken it as a donation.
- It gives a right to information from the banker or other person who has information at their disposal regarding the cheque after its loss or theft.

Our courts typically hear matters that require deciding who is the true owner of a cheque. In some cases the cheque is stolen and then either cashed by the thief with a third party, or deposited by the thief into his or her bank account. This raises questions of the liability of the bank and the

third party, and whether the person to whom the money was truly owed can claim from either or both.

Section 81 entitles the person to whom the money is truly owed on a crossed cheque marked ‘not negotiable’ which is stolen or lost and subsequently paid by the bank, to recover any loss he or she may have suffered from any person who possessed the cheque after its theft or loss who either gave consideration for it or took it as a donation. There is an irrebuttable presumption that a person who deposits a cheque into their bank account gave value for it. This means that you cannot avoid liability by saying that you were just allowing someone to use your bank account.

The words ‘not negotiable’ operate as a red light and a warning to all who take the cheque: ‘Beware! This cheque may be stolen!’

12 Bank certified cheques

A bank-certified cheque contains a marking by a drawee bank that the cheque is good for payment.

13 Bank guaranteed cheques

The drawee bank undertakes to the payee that the cheque will be paid on presentation. This is a form of contractual obligation by the bank to honour the cheque, and may be subject to various conditions. The guarantee also affects the power of the drawer to cancel payment of the cheque. The drawer is only allowed to stop payment by obtaining a court order, which will only be granted where fraud is suspected.

14 The cambial obligation

Once certain requirements are met, the issue of the cheque and every subsequent indorsement creates a ‘cambial obligation’. The cambial obligation is a warranty by the drawer and each indorser that the cheque will be paid by the drawee, and that if not, the drawer or indorser will pay it. This undertaking is conditional on the cheque having been dishonoured and notice of dishonour having been given to the party being held liable.[38]

Any party who has signed the cheque is liable, jointly and severally, with all other signers. In effect, the drawer and all indorsers guarantee payment and will be liable. This means that a single cheque can embody as many obligations as there are signatories to it. A party who did not sign the cheque (for example a party who transferred a bearer cheque by delivery) did not guarantee payment and therefore will not incur any cambial liability on the cheque.[39]

The cambial obligation is separate from the obligation for which the cheque was drawn. If the cheque is dishonoured, the creditor still can choose to enforce the contract and use the cheque as evidence in proof of the claim. If rights under the original contract have been ceded, the cambial obligation on the cheque can still be sued upon.[40]

15 Liability on a cheque

A person suing on a cheque must prove all of the following:

- The cheque was valid in accordance with the provisions of the Act.
- The cheque was signed by, or on behalf of, the person being sued.
- The person suing is the holder of the cheque and therefore entitled to sue.
- The cheque was dishonoured for non-payment.
- Notice of the cheque being dishonoured either was given, or was not necessary.

South African law distinguishes between two kinds of defences: absolute and relative defences.[41]

15.1 Absolute defences

These go to the root of the cheque and affect its existence. They are known as ‘absolute defences’ because they can be raised against all holders, including a holder in due course. They include the following:

- **Lack of capacity**: This defence may only be raised by a person who himself or herself lacks capacity, and not by any successor in title to the cheque.
- **Prescription**: The cambial obligation in respect of a cheque is extinguished by prescription if six years have passed since the cheque was drawn. Prescription on the underlying obligation runs separately. In effect this means that if a cheque is used to pay a price on a contract, the right to sue under the contract will prescribe after three years, whereas the right to sue on the cheque will prescribe after six years.

> ***Lutzkie and another NNO v Zenith Concessions Ltd*** [42]
>
> A company bought shares and paid with a cheque. Summons was only served on the defendant more than three years after the debt had become due. The plaintiff was met with a defence of prescription.
>
> The court held that the underlying debt and the cheque were extinguished by prescription at different times. The prescription period for the debt was three years,

but the prescription period for the cheque was six years. That period had not expired by the time summons was served and accordingly the defence of prescription failed.

- **Cheque left incomplete**: This is also referred to as ‘inchoate’, and means a signed cheque is lacking in one material aspect. For example, the name of the payee was not filled in, or the cheque was not delivered, by or on behalf of the person being sued, or with the intention of being used as a cheque at all.
- **Signature was forged or unauthorised**.
- **Signature was by an accommodation party**: Someone who signs a cheque to raise its standing in order to enable someone to raise money on it, does intend to be liable to the financier as well as any further holder.
- **Signature of an aval**: A person who signs a cheque as surety is known as an aval. The aval must sign the cheque and expressly write words to indicate that he or she is a surety, by using words such as ‘as aval’, ‘as surety’, or ‘as guarantor’. An aval may become a surety for the drawer or indorser of a cheque. If not specified, it is assumed that the suretyship will be for the drawer. The aval is jointly and severally liable with the person for whom he or she has provided the suretyship, and cannot rely on the benefits of excussion or division to avoid liability.
- **Material alteration to the cheque after signature or indorsement**: This includes any changes made to the date, sum payable, or time or place of payment. Despite such alteration, the signer still will be liable to the extent of his or her liability as of the date of his or her signature or indorsement of the cheque.
- **No intention to incur liability**: Two possible situations may arise:
  - ***Non est factum***: This defence means that the person was tricked into signing the cheque and believed he or she would not be bound. He or she admits to signing the cheque, but denies that there was an intention to be bound. The person cannot avoid liability if he or she were careless in signing.[43]
  - **Signature in a representative capacity only**: The person who signed the cheque claims that he or she signed on behalf of another and therefore is not personally liable. The person must have had authority. If there were no authority to sign, he or she will be personally liable. The person must also indicate clearly on the cheque

itself that he or she is signing in a representative capacity, by using words or letters recognised as signifying agency, for example ‘as agent for’ or ‘on behalf of’. If this is not done, he or she will be estopped from denying liability.[44]

If the person's signature were part of a stamp imprinted on the cheque with the name of the company, he or she will not be liable.[45]

If the person claims to have signed on behalf of a company, then the full and correct name of the company must be reflected on the cheque. If it is not, he or she will be personally liable on the cheque.[46] If signing on behalf of a close corporation, the full name and registration number must appear on the cheque, or else the signer will personally be liable.[47]

15.2 Relative defences

These relate to the obligation underlying the cheque. They are called ‘relative defences’ because they may be raised against any holder, except a holder in due course. It is for this reason that a holder in due course is in a privileged position, because only a limited number of defences can be raised against him or her.

Examples of relative defences include the following four situations:

- **Delivery without the authority of the drawer or indorser**: This defence is not available against a holder in due course. Where the cheque is in the possession of a holder in due course there is a conclusive presumption of valid delivery by all parties prior to him or her.[48]
- **Delivery subject to an unfulfilled condition, or for a special purpose and not for the purpose of transferring title**: This defence is not available against a holder in due course. Where the cheque is in the possession of a holder in due course, there is a conclusive presumption of valid delivery by all parties prior to him or her.[49]
- **Absence of reasonable cause**: The obligation for which the cheque was issued is invalid, has fallen away, or is discharged. This may be due to the cheque being for an illegal consideration or a wagering agreement, or because of fraud, breach of faith, misrepresentation, duress, undue

influence, or set-off.[50] This defence is not available against a holder in due course who holds the cheque free from the personal defences available to prior parties.

- **Cheque left incomplete**: A signed cheque lacking in one material aspect (for example, the name of the payee was not filled in), and the cheque was delivered, but not completed either within the time allowed or in accordance with the extent of the authority granted.

16 True owner's rights of recovery

The true owner is someone who is entitled to possession of the cheque and to payment in terms of it. The payee normally becomes the true owner on receipt of the cheque. Where the payee either expressly or tacitly requests the drawer to post the cheque, the payee will normally become the true owner when the cheque is posted.[51]

***The Godfather v Commissioner for Inland Revenue*[52]**

A refund cheque was posted to the wrong person, and not to the taxpayer to whom it should have been sent. Similar cheques had been posted to the taxpayer before, and he had never objected.

The court held that the taxpayer had never been asked whether the post was acceptable, and that the true owner of the cheque was the Commissioner.

The true owner will have a delictual action against the following:

- Any dishonest intermediary.
- The drawer, if the true owner is the payee and the drawer was negligent.
- Any bank acting in bad faith or negligently.

The collecting bank owes a duty not to be negligent when dealing with a cheque that may cause loss to the true owner. It also must exercise reasonable care when collecting cheques to ensure that they are not credited to the accounts of people who are not entitled to them. This standard of care must be reasonable with regard to the skill, care and diligence exercised by members of the banking profession generally. Internal standards are not conclusive proof of a reasonable standard.[53]

Payment should be collected strictly in accordance with an instruction appearing on the cheque itself, for example a marking of ‘non-transferable’.[54] However, section 75A(2) of the Act provides that a bank will not be negligent if it fails to comply with an indorsement or marking that prohibits transfer, other than one with the words ‘not transferable’ or ‘non-transferable’.

The collecting bank should check the validity of any signature on any indorsement, or take steps to verify the indorsement before payment is made.[55] Similarly, the bank should check the identity of a new client who

opens an account. An existing client who applies for additional facilities need not be checked up on, unless special circumstances exist.[56] In conducting the investigations, the bank must balance the interests of the client, its own business interests, and the risk of loss to the true owner.

17 Liability of the bank

17.1 Payment contrary to a crossing

In terms of section 78(4) of the Act, the bank is liable to the true owner to the extent that the bank pays out contrary to any crossing. The bank will not be liable if it pays in good faith and without negligence, if it appears that there is no crossing, or that the crossing has been altered in accordance with the Act.

17.2 Premature payment of a post-dated cheque

A bank may not reduce a client's account until the date specified, and may not do so at all if the cheque is stopped prior to that date.

17.3 Material alteration of a cheque

A bank is entitled to reduce a client's account only by the amount that the client intended. If the amount is increased without the client's authority, the bank can only reduce the client's account by the original amount.

If the amount has been fraudulently increased after a cheque was drawn and the bank pays the increased amount, the general rule is that the bank is liable for the difference. The client has a duty to draw cheques in a way that is not negligent. The bank has a defence only if the client was negligent.[57]

18 Other forms of payment

18.1 Traveller's cheques

These documents are accepted internationally and may be issued in different currencies.

The normal procedure is that the traveller signs the documents for the first time, immediately on purchasing them. To pay a supplier, the traveller will sign the document again. The two signatures must match to be accepted. Traveller's cheques protect against theft because if a cheque is stolen before it is signed the second time, the issuer will either replace the cheque or reimburse the traveller. However, if it is stolen after the second signature has been made, the issuer will generally not have to reimburse the traveller, because the cheque is payable to bearer.

Although traveller's cheques are instruments of payment, and are negotiable, they cannot be classified as bills of exchange, cheques, or promissory notes under the current definitions applicable in terms of the Act. This is because the requirement of the second signature makes the document a conditional one. Nevertheless, they are regarded as payable to bearer, and are negotiated by a process of delivery once the second signature matches the first.

18.2 Two-party credit cards

These cards normally are issued by retail chain stores and involve two parties: the store in its capacity as supplier and the cardholder in the capacity of an account holder at that chain of stores. The card carries the chain's corporate identity and the name, account number, and signature of the account holder. The amount of available credit is limited, and purchases may be made only at that particular chain of stores.

18.3 Three-party credit cards

The issuer of the card is a financial institution such as a bank. There are three parties involved and two separate contracts.

- In the first contract, the bank contracts with suppliers, and undertakes to pay suppliers for goods supplied to persons who pay by credit card. The bank makes money by deducting a percentage of the price payable as a commission.
- The bank also contracts with its cardholders, to deduct from the cardholder's account the full purchase price of goods supplied by suppliers. The bank makes additional money by charging its cardholders for the contract. The amount of available credit is limited, and purchases may be made at any supplier who has contracted with the bank.

Credit cards have four important functions:

- **Payment**: The cardholder's bank account is debited by the bank, and the bank pays the supplier the amount, less a commission. This means that the cardholder does not have to make direct payment to the supplier, therefore making the use of credit cards safer than carrying cash.
- **Credit**: The bank only pays the supplier after a certain amount of time, meaning that the goods have been supplied to the cardholder on credit. Similarly, the cardholder only pays the bank after a certain amount of time, meaning that the bank grants credit to the cardholder. The cardholder is charged interest on the credit amount by the bank.
- **Cash**: By linking credit cards to automatic teller machines, it is possible for the cardholder to obtain immediate cash, and reimburse the bank on credit.
- **Identification**: Credit cards may be used to identify people or verify their ages, since normally only persons over 18 years of age are issued credit cards by a bank. This is particularly useful for transactions conducted over the internet.

The cardholder normally bears the risk of loss of a card until such time as the bank is notified of the loss. After that, the bank bears the risk. It is advisable for cardholders to insure against this risk. A supplier bears the risk if it accepts a card it knows to have been lost.

18.4 Letters of credit

When importers and exporters buy and sell across international borders, a mechanism is needed to make certain that the right persons are correctly paid.

Payment may be achieved by the buyer and seller agreeing to use a letter of credit. The buyer's bank then will issue the letter of credit in favour of the seller. This letter normally has terms and conditions that apply, such as when payment must be paid, whether payment is made in cash or by negotiable instrument, whether the letter can be revoked or not, whether the letter can be transferred, or whether the issuing bank or another bank will make the payment once the terms have been complied with.

On receipt of the letter of credit, the seller will send the goods to the buyer, and then will claim payment from the issuing bank. The seller also will hand to the bank the relevant documents to enable ownership to be transferred to the buyer. Once the bank has paid the seller, it will claim payment from the buyer. On receipt of payment, it will provide the buyer with the documents necessary to enable the buyer to acquire ownership of the goods.

There are generally six types of letters of credit:

- **Draft credit**: This letter of credit undertakes to make payment by bills of exchange.
- **Cash credit**: This letter of credit undertakes to make payment in cash.
- **Revocable credit**: This letter of credit contains terms allowing the issuer to revoke the letter of credit at any time after it has been issued.
- **Irrevocable credit**: The bank undertakes to make payment provided that the terms of the letter of credit have been complied with. The letter of credit cannot be withdrawn unless in accordance with these terms.
- **Confirmed credit**: The letter of credit issued by one particular bank has been confirmed by another bank. This means that the confirming bank also undertakes to make payment. This type of letter of credit is useful where the issuing bank does not operate a branch in the country where payment must be made.
- **Transferable credit**: The original beneficiary may transfer the whole or part of the credit to another.

18.5 Stop orders

An account holder instructs his or her bank to make regular payments to a third party on behalf of the account holder. The amount paid then must be deducted from the account holder's account.

The bank acts under a contract of mandate with the account holder, and payment is made to the third party only if sufficient funds are in the account holder's account. The creditor has no right against the bank, and the account holder may cancel the stop order at any time.

Stop orders are useful to ensure that insurance and rental payments are made regularly and promptly.

18.6 Debit orders

A debit order form is completed by an account holder and given to a creditor. The form requests the creditor to make withdrawals from the account holder's account, and authorises the account holder's bank to make payments to the creditor, and to debit his or her account in the amount of the payments. The creditor makes regular withdrawals by completing a debit slip and sending it to the account holder's bank.

A debit order comprises both a mandate by the account holder to the bank and an authorisation to the creditor to make requests for payment from the bank. The rights of the creditor to sue for payment are suspended until the debit slip has been sent to the bank and payment requested.

18.7 Electronic transfer of funds

The bank or financial institution is instructed by a client with an account to make or receive payment from or to the account. Funds are then transferred into or from another account operated at the same or another financial institution or bank. The bank acts for the client under a contract of mandate.

Clients can use three different types of electronic funds transfer systems:

- **Automatic teller machines (ATMs)**: The bank issues clients with a card that carries a magnetic strip and a personal identification number (PIN). By inserting the card into a specially designated machine, and typing in the PIN, various facilities offered by the bank may be accessed, such as cash withdrawals from the accounts operated by the owner of the card. Normally, the ATM is connected directly to the computers operated by the bank and a verification process takes place to ensure that the card has not been reported stolen or lost, and that the account holder has sufficient funds to meet the request made at the

ATM. The ATM cannot verify that the person who inserts the card and types in the PIN is in fact the account holder. The account holder will be liable for all withdrawals made by unauthorised users of the card until such time as he or she informs the bank that the card has been stolen or lost.

- **Electronic funds transfer at point of sale (EFTPOS)**: Electronic payments may be made in shops by using an ATM card or a credit card. The client selects from which account payment is to be made, for example a savings account or a credit card account. The supplier types in the amount of the payment, and the client then types in his or her PIN. Provided there are sufficient funds in the designated account, the amount is then transmitted to the supplier's account. The contract is complete once payment has been made by the bank. Where payment is made to the wrong person or in the wrong amount, the doctrine of unjustified enrichment will apply.
- **Home banking**: The bank normally contracts with the client to exclude any liability in the event of any wrong transfer of funds, or for the service not being available at any time.

18.8 Electronic cash (e-cash)

Many people are concerned about the commercial security of providing credit card details to a supplier on the internet. Electronic cash (e-cash) provides a solution. Credits for a particular amount are bought from a participating bank and used to trade on the internet. The seller accepts the e-cash credits as payment, and redeems the value in local currency from a participating bank.

E-cash does not fall within the definition of legal tender as contained in the South African Reserve Bank Act.[58] This means that unless various laws are changed, payment in e-cash will not legally discharge a contractual obligation to pay. In future, it is possible that e-cash may be considered a negotiable instrument, or an electronic letter of credit. Potential problems will include taxation on transactions and foreign exchange control regulations.

18.9 Secured electronic transactions (SET)

Secured electronic transactions (SET) technology is being applied by the issuers of credit cards to ease people's fears about the security of internet transactions. A sophisticated encryption technology is used to ensure that credit card accounts are secured. A person who provides a supplier with credit card information over the internet retains security over his or her credit card account by using a digital signature as a form of parallel security.

Generally, a digital signature has the same legal effect as a manual signature. This is as long as it is unique to the person using it, under his or her control, capable of being verified, and becomes invalid immediately if the data is changed.

PRACTICALLY

SPEAKING

Issuing cheques[59]

- Do not use post-dated cheques as they may cause problems if paid in before the date shown by being returned unpaid or being cleared before you are expecting it.
- Always keep cheque guarantee cards and chequebooks separate.
- Help prevent fraud by adding extra information on the payee line after the name such as invoice or contract numbers.
- Draw a line through unused space on the cheque to avoid unauthorised people adding extra details.
- Write the cheque out by hand using large print, pressing very firmly on the paper. This makes it more difficult for dishonest people to use a chemical solvent on the cheque to change details.
- Record details of cheques issued on chequebook counterfoils and carefully check against bank statements so discrepancies can be picked up and reported to your bank or building society.
- Always keep cheques that have been paid and returned from the bank locked in a safe place. Thieves sometimes steal these and use a chemical solvent to wipe off the bank stamp and name of the payee, and write their own name in as the payee.
- Always cross a cheque and mark it writing the words ‘not transferable’ on the face of the cheque.
- Try to allocate responsibility for issuing cheques. Reconcile bank statements twice, using different people each time.
- If using a company chequebook, consider having two signatories for every cheque.
- Ask your bank about using special cheques with additional security features to prevent fraud, such as watermarks, metal strips and paper that dissolves when any chemical solvent is applied.
- Consult your bank on the best payment method when dealing with cross-border suppliers, as cheques issued by South African banks (even if denominated in another currency) may be for use in South Africa only.

THIS CHAPTER IN ESSENCE

1 A negotiable instrument is a document that contains a promise that the person in possession of the document (the holder) will be paid a specified amount of money.
2 A cheque is an unconditional order in writing, addressed by a person to a banker, signed by the former, requiring the banker to pay on demand a sum certain in money to a specified person, or to that person's order, or to bearer.
3 The two most important characteristics of a negotiable instrument are simplicity of transfer of title and transferability free from equities.
4 Where the cheque is not payable to a specified person, or is indorsed only to bearer, it is called a bearer instrument.
5 South African law distinguishes between four categories of holder: the holder; holder for value; holder in due course; and the holder who derives title from a holder in due course.
6 A holder in due course is protected against all relative defences relating to the obligation underlying the cheque. He or she acquires ownership in the cheque even when it was acquired from a non-owner, and obtains an indisputable right to claim payment.
7 To be valid, the indorsement of an order cheque requires signature plus the intention to indorse and undertake the liabilities of an indorser. The signature does not need any additional words, and no date of indorsement needs to be written.
8 Three types of indorsement can be made: blank, special, or restrictive.
9 Cheques may be crossed with a general crossing or a special crossing.
10 Cheques may be marked with the words: ‘Account payee only’, ‘Only’, ‘Not negotiable’, ‘Not transferable’ or ‘For collection’.
11 The bank may refuse to make the payment if the cheque does not comply with the necessary essential elements, or with the rules imposed by the bank.

12 Banks are protected by section 79 of the Act with respect to forged indorsements and to crossed cheques that are marked ‘not transferable’. With uncrossed cheques, section 58 of the Act may protect the bank in certain circumstances. Section 81 operates where a crossed cheque marked ‘not negotiable’ has been lost or stolen and the drawee bank is protected by section 79.

13 The cambial obligation is a warranty by the drawer and each indorser that the cheque will be paid by the drawee, and that if not, the drawer or indorser will pay it. This undertaking is conditional on the cheque having been dishonoured and notice of dishonour having been given to the party being held liable.

14 Absolute defences can be raised against all holders, including a holder in due course.

15 Relative defences may be raised against any holder, except a holder in due course.

16 Section 75A(2) of the Act provides that a bank will not be negligent if it fails to comply with an indorsement or marking that prohibits transfer, other than one with the words ‘not transferable’ or ‘non-transferable’. Under section 78(4) of the Act the bank is liable to the true owner to the extent that the bank pays out contrary to any crossing.

QUESTIONS

Short questions (1–5 marks)

1 Define the two major characteristics of negotiability.
2 Define what is meant by a bill of exchange.
3 Define what is meant by a cheque.
4 List seven requirements to be a holder in due course.
5 List the four types of holder.
6 List the four parties to a cheque.
7 Name two characteristics that distinguish a cheque from other bills of exchange.
8 Define what is meant by a traveller's cheque.
9 List four functions of credit cards.
10 List four types of letters of credit.

11 List three types of electronic funds transfer systems.
12 Name two problems associated with the use of e-cash.

Paragraph questions (5 marks)

1. What does it mean to be a holder in due course?
2. Analyse whether a traveller's cheque is a negotiable instrument.
3. Discuss the problems associated with the use of e-cash.
4. Discuss the elements of the definition of a bill of exchange.
5. Distinguish between a stop order and a debit order.
6. Discuss the various ways by which payment can be made electronically.

Essay questions (10 marks)

1. Discuss the effects of various crossings and markings of cheques.
2. Discuss the effect of sections 79, 80, and 81 of the Bills of Exchange Act.
3. Discuss absolute and relative defences when suing on a cheque.

Problem questions (20 marks)

1. Aaron draws a cheque on Big Bank in favour of Charles or order. The cheque is crossed and marked ‘not negotiable’. The cheque is negotiated by Charles to Darren. When Darren presents the cheque for payment, he learns that Aaron has stopped payment of the cheque. Advise Darren whether he is entitled to enforce payment of the cheque against Aaron. Would your answer be different if the cheque had been marked ‘not transferable’?
2. Steven is the company secretary of the Megacorp company and is authorised to sign cheques on behalf of the company. Advise him on the best way in which he should make out the cheques and how he should sign them so that:
   a. He does not incur personal liability on the company's cheque.
   b. Megacorp company obtains maximum protection against loss or theft if the cheques are sent through the post.
3. Absolom draws a cheque on Little Bank payable to Brutus or order. He crosses the cheque, adds the words ‘not negotiable’

and delivers the cheque to Brutus. Carrie steals the cheque from Brutus, forges Brutus's signature on the back of it and delivers the cheque to Damien. Damien deposits the cheque in his account with Big Bank and Little Bank pays Big Bank. Advise Brutus of his legal position.

4. A cheque is made out to ‘Robert Jones or order’. It is not crossed and not marked ‘not transferable’. There is no indorsement. Consider the following:
   a. Can the bank pay the cheque over the counter? If yes, to whom can it be paid over the counter? If no, why not?
   b. If the teller asks the person presenting the cheque for payment to sign it on the reverse side, to whom can it be paid?
   c. What function is served by the signature on the reverse side?
5. Zoltan sells a refrigerator to Winnie. Winnie gives him a cheque for R1 000. Zoltan indorses the cheque to Penny. When Penny claims payment on the cheque from Winnie, Winnie says that the refrigerator was defective and refuses to pay out on the cheque. Explain.
6. Daniel, who had never had any dealings with Phil, signed a cheque in blank and handed it to Eric so that Eric might make certain payments on Daniel's behalf. Eric fraudulently completed and delivered the cheque to Phil, who accepted it in payment for certain goods sold and delivered. The cheque was made payable to Phil or bearer. The cheque was dishonoured for non-payment. Phil then sued Daniel, alleging that he was a holder in due course. Daniel alleged that Phil was not a holder in due course, because the cheque had been signed in blank and not completed in accordance with the authority which Daniel had given Eric. Was Phil a holder in due course? Could Phil enforce the payment of the cheque against Daniel? Discuss fully.
7. Anne draws a cheque on Big Bank in favour of Chen. Denny steals the cheque from Anne and, after forging Chen's signature, pays off a debt owing to Ephraim with the stolen cheque. Is Ephraim a holder? Is Ephraim a holder in due course?

   Ackie draws a cheque on her local branch of Big Bank in favour of Carol. Dotty steals the cheque and presents it for

payment to Big Bank, pretending she is Carol. Big Bank pays Dotty over the counter. Who bears the loss: Ackie or Big Bank? If Dotty had indorsed the cheque to herself, forging Carol's signature before claiming payment, who would bear the loss?

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1 Bills of Exchange Act 34 of 1964.

2 Gibson, 462–463.

3 *Hill v The Colonial Banking and Trust Company* 1927 TPD 148.

4 Ibid.

5 Gibson, 463–466; Havenga et al., 167; Sharrock, 475; Swanepoel, 115–120.

6 Havenga et al., 168–171; Kahn, *Contract and Mercantile Law through the Cases* Vol 2, 473; Sharrock, 477–480; Swanepoel, 120–124.

7 *Salot v Naidoo* 1981 (3) SA 959 (D).

8 Interpretation Act 33 of 1957.

9 *Dependable Aluminium Windows and Doors CC v Antoniades* 1993 (2) SA 49 (N).

10 *Goldschmidt and Co v Wallis* (1884) 2 HCG 550; *Moon and Co (Pty) Ltd v Jacobs and others* 1949 (4) SA 45 (T); *De Beer v Diesel and Electrical Engineering Co* 1960 (3) SA 89 (T); *Investors Club Ltd v Jaap de Villiers Beleggings (Edms) Bpk and others* 1978 (3) SA 1960 (W).

11 *Van Tonder en andere v Vorster* 1996 (3) SA 383 (A).

12 *Weszak Beleggings (Edms) Bpk v Venter* 1972 (1) SA 730 (T).

13 *Hitchcock v Edwards* (1889) 60 LT 636.

14 *Bank of England v Vagliano Brothers* [1891] AC 107 (HL).

15 Gibson, 482–496; Havenga et al., 171–175; Sharrock, 488, 493–497.

16 Kahn, *Contract and Mercantile Law through the Cases* Vol 2, 502.

17 *Bank of England v Vagliano Brothers* [1891] AC 107 (HL).

18 Bills of Exchange Act 34 of 1964.

19 *Moli and Company v Cassim's Trustees* 1924 AD 720.

20 Sharrock, 503–507; *Ramsukh v Diesel-Electric (Natal) (Pty) Ltd* 1977 (4) SA 242 (SCA).

21 *Estate Ismail v Barclays Bank (DC and O)* 1957 (4) SA 17 (T); *Mourgelas v Maindanos* 1973 (4) SA 297 (T).

22 *Sappi Manufacturing (Pty) Ltd v Standard Bank of SA Ltd* 1997 (1) SA 457 (A).

23 *Silcan Estate and Finance Co (Pty) Ltd v Astra Café* 1973 (3) SA 7 (N).

24 *Jaffer v Nell* 1958 (3) SA 497 (C).

25 Sharrock, 491.

26 Sharrock, 491.

27 *Standard Bank of South Africa Ltd v Sham Magazine Centre* 1977 (1) SA 484 (A).

28 Fouché, 171; Gibson, 497–498; Havenga et al., 188–191; Kahn, 1985, 607; Sharrock, 188–189; Swanepoel et al., 127; Tager, 98.

29 Gibson, 498–499; Havenga et al., 187; Sharrock, 489–490.

30 *Standard Bank of South Africa Ltd v Sham Magazine Centre* 1977 (1) SA 484 (A).

31 *Fonds Adviseurs Bpk v Trust Bank van Afrika Bpk* 1974 (4) SA 883 (A).

32 *Gishen v Nedbank Ltd* 1984 (2) SA 378 (W); *Impala Plastics (Pty) Ltd v Coetzer* 1984 (2) SA 383 (W).

33 *ABSA Bank Ltd v Blumberg and Wilkinson* 1997 (3) SA 669 (A).

34 *Standard Bank of South Africa Ltd v Peens and others* 2005 (1) SA 315 (SCA).

35 Sharrock, 491–495.

36 *Holzman v Standard Bank of South Africa Ltd* 1985 (1) SA 360 (W).

37 *ABSA Bank Ltd v Greyvenstein* 2003 (4) SA 537 (SCA).

38 Sharrock, 491–495.

39 Gibson, 499–504; Sharrock, 492.

40 Sharrock, 490–492.

41 Gibson, 484–485; Kahn, *Contract and Mercantile Law through the Cases* Vol 2, 575; Sharrock, 497–503.

42 *Lutzkie and another NNO v Zenith Concessions Ltd* 2003 (6) SA 643 (SCA).

43 *Foster v Mackinnon* (1869) LR 4 CP 711; *Krige v Willemse* (1908) 25 SC 180.

44 *Kannemeyer and another v Lubbe and others* 1921 CPD 647; *Associated Engineers Company Ltd v Goldblatt* 1938 WLD 139.

45 *Nicolaides v Henwood Son Soutter and Company* 1938 TPD 390.

46 *Gummed Tapes (Pty) Ltd v Pillay* 1963 (2) SA 81 (W).

47 Section 23(2) of the Close Corporations Act 69 of 1984.

48 *Saambou-Nasionale Bouvereniging v Friedman* 1979 (3) SA 978 (A).

49 *Barclays National Bank v Serfontein* 1981 (3) SA 244 (W).

50 *Krige v Willemse* (1908) 25 SC 180; *Karabus Motors (1959) Ltd v Van Eck* 1962 (1) SA 451 (C); *Yannakou v Apollo Club* 1974 (1) SA 614 (A).

51 Sharrock, 493–497.

52 *The Godfather v Commissioner for Inland Revenue* 1993 (2) SA 426 (N).

53 Sharrock, 490–492.

54 *Volkskas Bank Bpk v Bonitas Medical Aid Fund* 1993 (3) SA 779 (A).

55 *Coetzee v ABSA Bank Bpk* 1997 (4) SA 85 (T).

56 *Powell and another v ABSA Bank t/a Volkskas Bank* 1998 (2) SA 807 (SE).

57 *London Joint Stock Bank Ltd v MacMilland and Arthur* 1918 AC 777; *Barclays Bank DCO v Straw* 1965 (2) SA 93 (O).

58 South African Reserve Bank Act 90 of 1989.

59 Source: https://payontime.co.uk/collect/collect-cheque-clearing.html, accessed 15 September 2008 © Dijital Media Ltd (formally known as Fontasia Ltd).

PART D: AGENCY AND EMPLOYMENT

How do other people make my business liable for what they say or do?

CHAPTER 22 Agency – *How do I authorise other people to do things for me?*

CHAPTER 23 Employment – *What are the differences between employees and independent contractors?*

CHAPTER 24 Labour legislation – *How do I ensure that my workers are treated properly?*

Chapter 22

Agency

'Let every eye negotiate for itself and trust no agent.'

WILLIAM SHAKESPEARE (1564–1616)
ENGLISH POET AND PLAYWRIGHT

What is covered in this chapter

1 Definition of agency
2 Creation and types of agency
3 Duties of the agent
4 Duties of the principal
5 The doctrine of the undisclosed principal
6 Special types of agency
7 Special types of representative
8 Liability of the agent on contracts
9 Termination of agent's authority

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Businesspeople often get others to enter into contracts on behalf of the business. For example, an employee is told to book a venue for a Christmas party.

Sometimes the authority is given by a written document; in most cases it is given by a simple verbal instruction, or it can arise in a particular situation or a practice that develops over time.

It is important that you understand how a contract of agency can be created, and what rights and duties apply to each person in the arrangement. Particularly, what remedies apply if an agent is dishonest, and how agency can be terminated legally.

1 Definition of agency

Agency is a contract by which one person (the agent) is authorised, and usually required, by another (the principal) to contract or negotiate a contract on the latter's behalf with a third person.[1]

2 Creation and types of agency

An agent is neither the employee of the principal, nor an independent contractor. The agent is not normally under the principal's direct control or supervision, but must nonetheless exercise his or her authority in accordance with the principal's instructions.[2] An agent is not just a messenger who passes on information from the principal, because the agent has a mind of his or her own, and performs legal acts.

As a general rule, an agent must have authority to enter into a contract in order to bind another person. Similarly, a person who lacks capacity cannot be an agent.[3] This means that a minor aged less than seven cannot be an agent at all; however, a minor who is over seven years old, with limited contractual capacity, can possibly be an agent.

There are two kinds of agent in South African law:

- **General agent**: Appointed to act generally for the principal. This may be limited to acting generally for the principal in all matters of a particular nature, for example regarding a specific business.[4]

> ***Faure v Louw*** [5]
>
> The owner of a business allowed his son to manage it. The son frequently signed cheques and made indorsements on promissory notes on behalf of the business. The father knew his son was doing this.
>
> The court held that there was an implied agency relationship, and that the father was liable for the cheques and promissory notes.

- **Special agent**: Appointed to carry out a specific act or to act for a specified limited purpose.

An agent may be appointed in many different ways, including explicitly, or impliedly through conduct, or even after the event by a process called ratification.[6]

2.1 Express appointment of an agent

No formalities are required to appoint an agent. The authority may be oral or in writing. The terms may be express or implied.[7] All that is required is that the parties agree on what has to be done by the agent (scope of authority), and the remuneration to be paid to the agent (normally paid in the form of a commission).

The amount of remuneration need not be expressed, but may be implied by trade usage. It is even acceptable to pay a ‘reasonable’ remuneration. Factors in determining the reasonable remuneration include time and labour by the agent, the value of the services as rendered to the principal, and the nature of the agent's occupation, together with all the circumstances of the case.[8]

A ‘power of attorney’ is a formal document in writing, setting out the scope of the agent's authority, and signed by the principal. Even an ordinary letter may effectively create and define the authority of an agent.[9]

A power of attorney must comply with provisions of the Deeds Registries Act[10] if it seeks to give authority to pass, cede, amend, or cancel a deed capable of being registered. The rules of the High Court require a power of attorney to be signed before a summons can be issued, or before notice is given of an intention to defend a case. Third parties, when dealing with agents, may insist that the authority of the agent be defined in a power of attorney.

There are two types of power of attorney:

- **A ‘special’ power of attorney**: This gives authority to a special agent who has authority to do one particular act.
- **A ‘general’ power of attorney**: This is given to a general agent who has general authority to act for the principal. The scope of the authority is governed by the scope of the wording of the power.

Powers of attorney are required by statute to be given to conveyancers to register a transfer of land or a mortgage bond; attorneys to institute an action for a client in the High Court; or to agents to buy or sell land.

No stamp duty is payable on a power of attorney.

2.2 Authority implied by law

Certain people have the power implied by law to act as agents and to bind others. For example a partner may bind the partnership, or the board of directors may act on behalf of the company, or the members may contract on behalf of a close corporation.[11]

Braker and Co v Deiner [12]

A partner signed on behalf of the partnership a consent to judgment in favour of a bookkeeper who sued the partnership for payment of accounting fees. The court had to decide whether the partner was able to bind the partnership after a court case had begun.

The court held that the partner would normally have implied authority to pay the accounts due to an accountant who performed professional services for the partnership. The fact that the partner had the authority to pay the accountant before the lawsuit was launched, meant that he must have had the authority to admit to the debt after the case had begun.

South African law recognises two situations where a person will have the authority to represent someone else, even without that person's consent.

2.2.1 Representative

Sometimes people have the power to represent others because of an office to which they are appointed. For example, an executor who represents a deceased estate, a curator who represents a person who has been declared incapable, a guardian who represents a minor, or a trustee who represents an insolvent estate. None of these situations involve agency due to the absence of any agreement. They are simply examples of representation without a mandate: there is no agreement, either explicit or implicit, in any of them.

2.2.2 Unauthorised management

A ‘manager without authorisation’ or a *negotiorum gestor* is a person who undertakes the business of another without the authority of the latter and in the latter's absence, with the sole object of benefiting the other person and with the intention of recovering his or her expenses.

This type of manager has no authority to represent the principal and is not entitled to remuneration. He or she may recover only appropriate expenses up to the amount the owner himself or herself would have spent. The manager is delictually liable for losses caused to the principal by his or her negligence. He or she must act reasonably.[13]

The principal must be incapable of acting for himself or herself. He or she does not have to be physically absent. It does not matter if the manager does not know the person whose affairs he or she undertakes to manage.[14]

A typical example of someone acting as an unauthorised manager or *negotiorum gestor* is someone who looks after a neighbour's house while the neighbour is away. If the house is broken into, it would be reasonable to have the locks replaced, and to recover the expenses from the neighbour.

The principal is entitled to receive an account of work done, and all monies or fruits received by the manager. The principal is also entitled to the return of the property in possession of the manager, who may retain possession pending reimbursement. If the manager has been negligent, the principal will also be entitled to claim damages.

The manager is entitled to indemnity for, and reimbursement of, all expenses reasonably incurred. He or she is not entitled to any profit.

2.3 Authority implied on the facts

Authority may be inferred from the conduct of the so-called principal. The conduct must be such that no interpretation can be made other than that the parties intended the relationship of principal and agent to exist between them.

The authorised agent may have additional, implicit authority to perform acts that are not strictly within his or her authority. It is the duty of the third party dealing with the agent to establish the limits of the agent's implicit or ‘ostensible’ authority. The onus of proof is on the person seeking to bind the principal.[15]

It is normally necessary to establish a series of acts or a course of conduct by the principal. For example, a domestic servant who has been duly authorised over time to make purchases from a shopkeeper. Similarly, managers of businesses have implicit authority to do all things reasonably incidental to carrying on that type of business, for example purchasing stocks on credit and issuing bills of exchange. However, they may not sell the business, or enter into compromises with creditors.

A person seeking to establish agency by ostensible authority must prove to the court four elements:

- There was representation by the principal, either explicitly or through the principal's conduct.[16]
- The representation reasonably could have been expected to mislead a third party.[17]
- The third party acted on the faith of the representation.[18]
- The third party was prejudiced by doing so.

Even where the principal denies the agent had authority, there are situations where the court will prevent the principal from claiming that the agent lacked authority. The ‘doctrine of estoppel’ applies where a person is prevented from relying on a set of facts that would normally allow them to escape liability. Estoppel is a rule of evidence where a person is not allowed to deny the truth of something he or she has previously stated. Because they have created the original impression of something being true, the court will not allow them to lead any evidence later which contradicts what they originally said.

In situations where the doctrine of estoppel applies, the agent has no explicit or implicit authority: the principal is simply prevented from denying the authority of the ostensible agent.[19]

The requirements to establish estoppel are as follows:[20]

- The principal must have made a representation to the third party that the agent did have the required authority. The representation may be made by words or conduct.
- The representation reasonably could be expected to mislead the third party.
- The third party acted on the representation to his prejudice.

> ***Quinn and Company Ltd v Witwatersrand Military Institute*** [21]
>
> A steward in charge of the non-commissioned officers' mess arranged a dance at the request of members of the mess. He obtained permission from the Institute, and also arranged catering. He had contracted on behalf of the Institute with the caterers several times before, and the accounts had always been paid. When sued on unpaid bills, the Institute stated that the steward had no actual authority to enter into the contract.
>
> The court held the Institute was estopped from denying that the steward had authority. It had held him out as the person in control and supervision of the mess, and had granted him permission to organise the dance.

2.4 Ratification of an unauthorised act

In the absence of authority, acts performed by professed agents may be adopted or ratified by the principal either explicitly or implicitly. This clothes the act with the same authority as if it had been authorised originally.[22]

There are four requirements:

- **The contractor must claim authority**: He or she must profess at the time of making the contract to be acting on behalf of a principal.[23]
- **The principal must be named or ascertainable**: The contractor must have contracted on behalf of the principal, and not just used the principal's name. If the principal is not named, it is sufficient if he or she is identifiable, for example as the owner.
- **The act must not have been illegal**: Illegal acts, or acts that are contrary to public policy, cannot be ratified. However, certain void legal

acts may be ratified, for example the ratification of a minor's unassisted contract.[24]

- **The principal must have been in existence at the time of the transaction**: It is possible to contract for the benefit of a third party not yet in existence. This rule is not of great importance in our law as the courts are inclined to interpretations making the transaction operative rather than inoperative.[25]

  The Companies Act[26] provides that a pre-incorporation contract contains an implied warranty by the person who entered into the agreement that the company will be incorporated, and that the contract will not be repudiated by the company after incorporation. A company may repudiate a pre-incorporation contract unless it has received any benefit in terms of the contract; however, a pre-incorporation contract that has not been repudiated is as valid and enforceable as if the company had been a party to the contract when it was made.

  In terms of the Close Corporations Act,[27] a close corporation is entitled to ratify after incorporation an act made on its behalf by an agent before it came into existence. The contract must be in writing; the contractor must have claimed to act as an agent or trustee for the close corporation to be formed; and the founding statement must contain the ratification or adoption of the contract as an object.

  It is not possible for a person to act in his capacity as trustee of a trust if the master has not yet issued letters of authority to such person in terms of the Trust Property Control Act.[28]

Ratification may be explicit or implicit and must be addressed to the agent or the third party with whom the agent dealt. Ratification will be implied where the principal behaves in such a manner that a reasonable person would believe he or she was ratifying the act of the professed agent.[29]

Ratification must occur within a reasonable time after the unauthorised act. Reasonableness depends on the facts of each case. The principal cannot ratify only part of an unauthorised agreement. Ratification of any part of the contract operates as ratification of the whole.[30]

The effect of ratification is to authorise the previously unauthorised act and give retrospective authority to the agent. This type of authority is given ‘after the fact’ or *ex post facto*.[31]

3 Duties of the agent

The agent has five common-law duties.[32]

3.1 To perform the mandate

The agent has a duty to perform the mandate fully and faithfully. If he or she does not, he or she forfeits the commission and becomes liable to the principal for damages arising from negligence.[33] It is sufficient if substantial performance has been made. The measure of what constitutes substantial performance will depend on the facts of each case. The test for substantial performance used by the courts is whether the transaction that resulted is not substantially different from the outcome that was authorised.[34]

3.2 To be honest and to show good faith

The contract of agency creates a relationship of trust (fiduciary relationship) between the agent and the principal. It is the duty of the agent to conduct the affairs of the principal in the interests of the principal and not for his or her own benefit.[35]

- **No secret profits**: The principal can always insist on having any profit accounted for. The agent is confined to claiming his or her commission.[36]
- **No conflict of interests**: The agent may not place himself or herself in a situation where his or her interests conflict, even if he or she acts honestly. If the agent makes full disclosure to the principal of the adverse interest, and the principal raises no objections, the agent will not be in breach of the duty of good faith.
- **No delegation of authority**: The agent generally must perform personally and may not delegate authority to a sub-agent, especially where the identity and personal attributes of the agent are of material importance to the principal.

  A person to whom something has been delegated may not delegate to someone else or employ a sub-agent without permission. This is

known as *delagatus non potest delegare*.

Where delegation is possible and there is explicit or implicit authorisation by the principal, the sub-agent is the agent of the original agent and not of the principal. Where the sub-agent is appointed without the consent of the principal, the agent remains personally liable to the principal for the negligence of the sub-agent.[37]

Consent to delegation may be implied by trade usage. Consent to delegation may also be implied by: consent of the principal; where employment of a sub-agent is necessary for performance of the agency; where it is customary in the normal course of that type of business to employ a sub-agent; where the act does not require the personal care and skill or discretion of the agent; where the delegated duty is purely administrative; or in an emergency.

- **No disclosure of information**: An agent may not disclose information acquired during the course of the agency to the detriment of the principal. The agent also may not use, for his or her own benefit, confidential information received through the agency.

Where the agent breaches the duty of good faith, the principal may repudiate the agency or stand by it. The principal also may refuse to pay the agent the commission, and may claim any bribe that was paid to the agent.[38]

3.3 To exercise due care

The agent must use such care, skill, and diligence as is reasonably necessary for the due performance of the mandate.

3.4 To act in accordance with the principal's instructions

Performance must be according to the explicit or implicit authority given by the principal. The agent must act within the scope of the authority. The agent may incur liability if the principal suffers a loss because the agent fails to comply with the undertaking. It is no defence for the agent to claim that the act was merely intended for the benefit of the principal.

3.5 To allow inspection of the books and to render an account to the principal

The agent must render a true and full account of any dealings in his or her capacity as agent. He or she must also permit the principal to inspect all books and records relating to the agent's transactions on the principal's behalf. The principal's rights must be exercised reasonably. The agent must keep his or her property separate from that of the principal. If he or she fails to do so, there is a presumption that all the property belongs to the principal.[39]

4 Duties of the principal[40]

The principal has three common-law duties.

4.1 To pay the agent the agreed remuneration if the mandate is substantially performed

There is no duty in law for a principal to pay the agent remuneration. The principal must only pay the agent if the agent has substantially performed the mandate, and there has been an agreement to pay or there is a trade usage to pay.[41]

Where there is no explicit agreement on the amount of payment, the amount is decided by the ordinary rules governing the implication of terms into a contract.[42]

The amount of commission payable also might be determined by trade usage. The court will award ‘fair and reasonable remuneration’, based on all the circumstances, including time and labour by the agent, the value of the services to the principal, and the nature of the agent's occupation.[43]

4.2 To reimburse the agent for expenses properly incurred

The principal must reimburse the agent for expenses necessarily incurred in the execution of the mandate.[44]

The agent is not entitled to reimbursement for expenses incurred from his or her own negligence, default, or breach of duty.[45]

4.3 To indemnify the agent for all losses he or she has suffered as a result of the execution of the mandate

The agent is entitled to be indemnified by the principal for all loss and liability duly incurred by him or her in executing the mandate, or directly caused by its execution.[46]

The right to indemnity applies only to losses incurred directly as a result of the authorised act. If an agent acts outside the mandate, he or she will be personally liable for all losses.

Set-off operates if the agent is owed commission by the principal and has money of the principal in his or her possession: the agent is allowed to pay only the remainder to the principal.[47]

Where the agent has none of the principal's money in his or her possession, he or she has a lien over the principal for the commission, any expenses, and any losses. A lien is a right of retention, that is, a right to retain possession of property belonging to another person as security for some claim in respect of that property, until that claim has been paid. The lien is immediately lost on the loss of possession of the property.

5 The doctrine of the undisclosed principal[48]

Our law of contract provides that only the parties to a contract can be bound by it and enforce it. This is the basis for the requirement that an agent must disclose to the third party that he or she acts on behalf of a principal. The failure to do so should result in there being no contract between the third party and the principal. However, our courts have recognised and enforced the doctrine of the undisclosed principal, in terms of which a third party may be entitled to hold either the principal liable, or the agent, in circumstances where the agent did not make disclosure.[49]

The following requirements must be met for the doctrine to apply:[50]

- The agent must be authorised to act on behalf of the principal. The doctrine will not apply where there has been ratification of authority.[51]
- The agent must intend to contract on behalf of the principal. The doctrine will not apply if the agent has the required authority but intends to act for himself or herself.[52]
- The agent must fail to disclose his agency at all to the third party. The doctrine will not apply if the agent tells the third party he or she is acting as an agent but simply fails to identify the principal.

Where the undisclosed agent contracts with a third party, and the above facts apply, the undisclosed principal can choose to enter the contract and ‘stand in the shoes’ of the agent. The contract will then be between the third party and the principal, and the agent falls out of the picture. On discovering the truth, the third party can choose to hold either the principal liable, or the agent. The third party cannot hold both of them liable.[53]

If the third party sues the agent, the agent will be estopped or prevented from claiming that he or she was not acting in his or her personal capacity, or that the principal has received the third party's performance.

If the third party sues the principal, the principal must perform to the third party, and will be liable to the third party even if the principal has paid the agent.

The doctrine will not apply in the following cases:[54]

- Where the agent acts on behalf of several undisclosed principals.
- Where the contract excludes the doctrine, either expressly or impliedly.
- Where the third party requires the performance to be rendered by the agent in particular, for example, for the performance of personal services.

Springfield Omnibus Service Durban CC v Peter Maskell Auction CC and another [55]

A buyer bought a bus at an auction sale. After delivery, the original registration certificate was not available and registration of ownership of the vehicle could not be transferred. The buyer argued that the owner was an undisclosed principal and that the buyer accordingly had an election to sue either the agent (auctioneer) or the undisclosed principal (owner).

The court held that the doctrine of the undisclosed principal, in terms of which personal liability vested in the agent of an undisclosed or unnamed principal, applied only where the buyer believed himself to be dealing with a principal when, in fact, he was dealing with an agent. The doctrine had no application to an auction sale because the buyer would have known the auctioneer to have been an agent of the seller.

There was no presumption that where an agent contracted for an unnamed principal he or she undertook personal liability. Once a party knew that there was a principal for whom the agent was acting, their intention could only be that they wished to contract with the principal through the agent. It followed that the auctioneer did not incur personal liability when acting for an undisclosed or unnamed principal.

6 Special types of agency

The people performing these acts are regarded as agents because they have the authority to bind their principals:[56]

- **Estate agent**: This person is authorised in terms of section 1 of the Estate Agency Affairs Act[57] to negotiate the sale of immovable property.[58]

  An estate agent is not an agent in the strict sense of the word because he or she normally is authorised only to find a buyer, and not to sign the deed of sale. An estate agent also does not have a contract of mandate with the seller, since the estate agent is not obligated to perform the task. He or she is simply given an opportunity to earn a commission.[59]

  An estate agent will only be entitled to a commission if, within the terms of the instructions given by the seller, he or she introduces to the seller a buyer who is willing and able to meet the terms of the seller. In a true agency relationship, normally a principal must pay an agent who has substantially performed the mandate. With estate agents, however, the seller pays a commission once a contract of sale has been concluded between the seller and a third party who is in a position to carry out the terms of the contract.[60]

  The estate agent is entitled to a commission even if the sale falls through. What is important is that the buyer is willing and able to buy at the time he or she is introduced to the seller. However, the estate agent will not be entitled to a commission where a new factor intervenes that equals or outweighs the effect of the introduction.[61] The contract of sale must also be enforceable. Commission will not be payable where the sale is subject to an unfulfilled suspensive condition, even if the parties agree otherwise.[62]

  The estate agent must prove that he or she was the ‘effective cause’ of the sale and entitled to a commission.[63]

To be the effective cause of the sale the estate agent must prove three elements:

- The estate agent found a buyer willing and able to buy on the seller's conditions.
- The estate agent put the prospective buyer into negotiations with the seller.
- The sale was bound to have gone through.

The introduction of the buyer may not mean that the agent was the effective cause of the sale.

***Barnard and Parry Ltd v Strydom*[64]**

The court held that the introduction will be the decisive factor where nothing intervenes to prevent the introduction from leading to the sale. But where the purchaser does not act immediately, for example because there are extensive negotiations or other events could promote the sale or discourage the parties, the decisive factor will be the exercise of 'the art of persuasion, or the removal of financial obstacles, or the like'.

Great difficulty arises in deciding whether or not an estate agent has been the effective cause of a sale where the seller has authorised more than one estate agent to find a buyer, or where the original negotiations have broken down and the buyer and seller subsequently negotiate the sale without recourse to the estate agent. The entitlement of an estate agent to a commission is a matter of fact to be decided in each case on the exact terms of the seller's instructions.[65] Where two or more estate agents have each satisfied the test of being the effective cause of the sale, the courts have awarded full commission to each estate agent.[66]

***Aida Real Estate Ltd v Lipschitz* [67]**

The court held that once a new factor intervened that was not made by the agent, the court must ask whether the new factor outweighed the effect of the introduction in bringing about the sale.

- **Factor**: A factor is employed to sell the principal's goods left in the factor's possession. The factor usually contracts with the buyer in his or her own name, and by so doing ensures that the factor remains personally liable under the contract. The factor has a general discretion to determine the price, warranties, and terms of the contract. If the goods are sold, however, the principal has a right to sue the buyer for the price.[68]

- ***Del credere* agent**: Sales agent who guarantees that a buyer is trustworthy. If the buyer defaults the agent compensates the principal (seller). To cover such risks, *del credere* agents charge higher than normal commission rates.[69]
- **Auctioneer**: This type of agent sells the principal's moveable or immovable property at a public auction. He or she is normally an agent of the seller.[70]

7 Special types of representative

South African law recognises that commercial acts may be performed by one person on behalf of another. The people performing these acts are not regarded as agents because they do not have the authority to bind their principals:[71]

- **Broker**: This person is not an agent, but only an intermediary who is appointed to communicate with both parties until they are in agreement on the terms and conditions of the sale. The broker normally does not have possession of the goods being bought and sold, and is not able to bind the parties. Only if the sale is agreed upon and goes through is he or she entitled to any commission (called brokerage).
- **Attorney**: An attorney's function is to enforce, defend, or settle the claims of his or her clients against others. He or she is normally not an agent, but performs his or her tasks according to the mandate given by the client.
- **Executor**: An executor represents a deceased's estate. In terms of the Administration of Estates Act,[72] he or she is neither the agent of the estate nor the agent of the heirs.
- **Trustee:** A trustee may be appointed in terms of a will or trust document, verbally, or on insolvency. His or her relationship to the trust is not really that of agent to principal. The trust will normally confer on the trustee contractual rights similar to that of a principal. Unlike agency, a trusteeship is normally not revocable at the will of the trustee.

8 Liability of the agent on contracts

As a general rule, a contract entered into by the agent acting within his or her authority will be valid and binding on the principal where the principal was named and disclosed.[73]

The principal will only be liable for delicts committed by the agent if the delict was committed in the course and scope of the agency, or if it was authorised by the principal. The principal may also be liable to a third party on the basis of unjust enrichment.[74]

Provided the agent acts within his or her authority, he or she will not be personally liable to the third party. However, where the agent acts without authority, he or she may bind himself or herself personally, and not the principal. Only if the principal subsequently ratifies the contract will the agent bear no liability.

There are three situations where the agent may be held personally liable:

- **Agreement**: Where the agent agrees to be personally liable, either expressly or impliedly.
- **Acting without or outside of authority**: Where the agent acts without authority, or exceeds the authority. In effect, the agent warrants that he or she has authority to bind the principal. If the principal fails to ratify the contract, the agent will be personally liable based on his or her warranty.
- **Failure to disclose the principal**: Where the agent acts within the authority, but does not disclose the principal to the third party. In this situation, there are two possibilities:
  - **Failure to disclose the fact of agency**: Where the third party is not told at all of the existence of the principal, the third party has the choice of holding either the principal or the agent liable.[75] Either the undisclosed principal or the agent may enforce the contract. If the undisclosed principal intervenes in the contract, the agent must perform to the principal.
  - **Failure to identify the principal**: Where the agent discloses that he or she acts for a principal, but does not name the principal, the courts

would hold the agent *prima facie* liable. However, where the agent is able to provide evidence that he or she was not intended to be a party to the contract, he or she can escape liability. In effect, there is a rebuttable presumption that the agent will be personally liable.[76]

9 Termination of agent's authority[77]

The authority of the agent will be terminated on any of the following:

- **Mutual consent of the principal and the agent to terminate the authority**.
- **Revocation by the principal**: Even if the agency has been described as irrevocable, the principal may still revoke the agency at any time.[78]

  In certain cases the revocation of the authority may be implied. For example, the principal, having given a specific power to one person, later grants a similar power to another person; or the principal issues a summons against the agent for the return of goods entrusted to him or her.[79]

  A power of attorney given by a person going overseas is implicitly revoked on the return of the principal.[80]

  The principal will not incur liability to the agent unless there is an explicit or implicit term entitling the agent to damages. The agent then must return the principal's property.[81] Where the agent has commenced performance, he or she is entitled to those damages he or she can prove were caused by the principal's revocation.

  When is the authority of an agent ever irrevocable? Generally, the following two requirements must be proved: authority must have been given not only for the benefit of the principal, but also for the benefit of the agent himself or herself, that is, where authority is coupled with an interest;[82] and there must also be agreement that the authority is irrevocable. Simply stating that the agent is given authority for his or her own benefit, or coupled with an interest, will not necessarily mean that the agency is irrevocable. The transaction will be interpreted and general principles of law will apply as to whether or not the agency is irrevocable.[83]

  The courts do not like to find that an agency can never be revoked. As a general principal, a contract of agency will always be revocable and the principal will be entitled to cancel the agent's authority, provided

that the principal will be liable for any damages suffered by the agent as a result of the breach of the agreement.

- **Renunciation by the agent**: The agent may reject the agency at any time. Unless this is done for a fair reason, he or she will be liable for any damages that the principal may prove, based on the ordinary rules of breach of contract.
- **Due performance of their respective obligations**.
- **Expiry of the period of time for which the authority was granted**.[84]
- **Death of either the principal or agent**.[85]
- **Insanity of the principal**.[86]
- **Insolvency of the principal**.[87]

PRACTICALLY

SPEAKING

Tips for using a power of attorney

A power of attorney is a convenient document to enable an agent to conduct affairs on your behalf. It is also a document that can be abused or used in fraudulent transactions. Whatever your reasons for using one, consider the following guidelines to ensure your legal interests are protected:

1 Choose your agent very carefully

Be very careful of so-called professionals with fancy titles such as ‘asset manager’ or ‘investment advisor’ whom you do not know. Issuing even a limited power of attorney to a stranger to handle your financial matters can be disastrous. A trusted friend, family member or your lawyer or accountant may be good candidates. Whoever you select must be loyal to you and there must be no conflict of interest. Always ask:

- Have they worked with others who have circumstances similar to yours?
- Are they licensed or registered with a professional organisation?
- Do they have the right insurances?
- Have they had any complaints?
- How are they paid? Is it an hourly rate, a flat fee, or a commission? Do they get a bonus for selling you a particular product?
- What are the fees and other costs for setting up and servicing your account?

2 Issue a specific power of attorney

There is no need to issue a general power of attorney if you only want your agent to handle certain matters. You can make your document as broad or restrictive as you need.

3 Specify an expiry date

A power of attorney comes into effect the moment you sign it unless you specify otherwise. Also specify an expiry date upon which it automatically becomes null and void and no revocation is necessary. If you are satisfied with the way your agent conducted your affairs, you can always issue another document. It is probably smartest to specify a fixed-term duration maximum of between one and six months.

4 Monitor the actions of your agent

Your finances must be kept in a separate account to that of your agent. Ask for regular accounting statements and reports. There is no governing body for agents. It is up to you to ensure that there is no abuse of power.

5 Termination of a power of attorney

If you revoke a power of attorney, you should do so both verbally and in writing. Be sure to send copies of the revocation to interested third parties such as your bank or the

deeds office. Ask your agent for the original document to be returned to you upon expiration or revocation.

THIS CHAPTER IN ESSENCE

1. Agency is a contract by which the agent is authorised, and usually required, by the principal to contract or negotiate a contract on the principal's behalf with a third person.
2. There are two types of power of attorney: a special power of attorney gives authority to a special agent who has authority to do one particular act; and a general power of attorney is given to a general agent who has general authority to act for the principal. The scope of the authority is governed by the scope of the wording of the power.
3. A manager without authorisation or a *negotiorum gestor* is a person who undertakes the business of another without the authority of the latter and in the latter's absence, with the sole object of benefiting the other person and with the intention of recovering his or her expenses.
4. Authority may be implied from the conduct of the so-called principal. The conduct must be such that no interpretation can be made other than that the parties intended the relationship of principal and agent to exist between them.
5. The common-law duties of the agent are: to perform the mandate; to be honest and to show good faith; to exercise due care; to act in accordance with the principal's instructions; and to allow inspection of the books and to render an account to the principal.
6. The principal has three common-law duties: to pay the agent the agreed remuneration if the mandate is substantially performed; to reimburse the agent for expenses properly incurred; and to indemnify the agent for all losses he or she has suffered as a result of the execution of the mandate.
7. The doctrine of the undisclosed principal allows the undisclosed principal to choose to enter the contract and ‘stand in the shoes’ of the agent.
8. To be the effective cause of a sale an estate agent must prove that he or she: found a buyer willing and able to buy on the seller's conditions; put the prospective buyer into negotiations

with the seller; and that the sale was bound to have gone through.

QUESTIONS

Short questions (1–5 marks)

1. List the two types of agent found in South Africa.
2. What is a special power of attorney?
3. What are the requirements to establish estoppel?
4. What does ‘ratification’ mean?
5. What does the phrase *delagatus non potest delegare* mean?
6. List three ways by which agency can be terminated.

Paragraph questions (5 marks)

1. Discuss various powers of attorney.
2. Discuss the requirement that all agents are required to perform their mandates in person.
3. When is an estate agent entitled to claim commission for the sale of a property?
4. What is the effect of a contract entered into by an agent who does not disclose the fact that he or she is acting on behalf of a principal?
5. Discuss the various methods of termination of agency.

Essay question (10 marks)

1. Discuss four ways by which agency may be created.

Problem questions (20 marks)

1. Jack owns a restaurant and, from time to time, commissions Kevin to buy wine for the business. On one occasion, Kevin, without authority, buys from Larry a consignment of wine that he thinks Jack will like. Larry refuses to deliver the wine when he learns that he can get a better price elsewhere. Later, once Jack has heard of Kevin's transaction, he tells Larry he wants to take the wine. Advise Jack.
2. Fikile authorises Graham to buy two delivery vans for him at a price not exceeding R15 000 per van. Graham owns such a van

and sells it to Fikile for R15 000. Graham then buys a second van from Hilton for R14 000 and receives a special commission of R200 for doing so. Graham sells this van to Fikile for R15 000. Fikile discovers everything. Advise Fikile.

3. Elizabeth gives Frank an option to purchase her business on credit. The option expires one month later. Frank goes overseas and his friend, Grant realises that the option will expire prior to Frank's return. Being unable to contact Frank, and believing that Frank would want to exercise the option, Grant exercises the option on Frank's behalf. Frank returns from overseas a day after the expiry date of the option, and ratifies Grant's actions. Advise Elizabeth, who no longer wishes to sell to Frank.
4. Michael drives past the scene of a terrible motor vehicle collision. He rescues Delila from the vehicle, and drives her to the nearest hospital where he signs all the forms and she is treated. Her life is saved because of his action. The hospital sends him all the bills. When he gives them to Delila, she refuses to pay. Advise Michael.
5. Priscilla is going overseas on holiday and authorises her best friend, Miriam, to buy a house for her. Miriam sees the perfect place, and secretly buys it for herself for R500 000. She then places it on the market, and buys it on behalf of Priscilla for R800 000. Priscilla is very angry when she finds out, and threatens to sue Miriam and the estate agent who sold her the house. She returns home immediately, but her flight is hijacked by terrorists and she dies. Advise Miriam.
6. Mark thinks he can make a lot of money buying flowers from a farmer and selling them for Valentine's Day. It is a very risky thing because he does not know if the weather will hold out, or whether the price of flowers will go up or down. He decides to be clever, and enters into the contract ‘on behalf of a company to be formed’. If everything goes well, he will form the company and pay for the flowers. If things go badly, he will claim there was never a contract. Advise Mark.

1 Fouché, 244; Gibson, 207; Havenga et al., 147; Sharrock, 136.

2 *Colonial Mutual Life Assurance Society Ltd v Macdonald* 1931 AD 412; *Fisk v London and Lancashire Insurance Co Ltd* 1942 WLD 63; *Ongevallekommissaris v Onderlinge Versekerinsgenootskap AVBOB* 1976 (4) SA 446 (A).

3 Gibson, 207–218; Havenga et al., 147–149; Sharrock, 136–139.

4 *Faure v Louw* (1880) 1 SC 3; *Nel v South African Railways and Harbours* 1924 AD 30.

5 *Faure v Louw* (1880) 1 SC 3.

6 *Maasdorp v The Mayor of Graaff-Reinet* 1915 CPD 636; *Coetzer v Mosenthals Ltd* 1963 (4) SA 22 (A).

7 *Vereenigde Adverteerders (Edms) Bpk v Tanner* 1947 (2) SA 1128 (T); *Hills v Taxing Master* 1975 (1) SA 856 (D) at 864.

8 *Hersov and Company v Spitz* 1927 TPD 938.

9 *Mahomed v Padayachy* 1948 (1) SA 772 (A).

10 Deeds Registries Act 47 of 1937.

11 Sharrock, 139.

12 *Braker and Co v Deiner* 1934 TPD 203.

13 *Amod Salie v Ragoon* 1903 TS 100.

14 *New Club Garage v Milborrow and Son* 1931 GWLD 86; *Williams Estate v Molenschoot and Schep* 1939 CPD 360.

15 *Strachan v Blackbeard and Son* 1910 AD 28.

16 *Weedon v Bawa* 1959 (4) SA 735 (D).

17 *Monzali v Smith* 1929 AD 383.

18 *Quinn and Company Ltd v Witwatersrand Military Institute* 1953 (1) SA 155 (T).

19 *Monzali v Smith* 1929 AD 383.

20 *NBS Bank Ltd v Cape Produce Co (Pty) Ltd and others* 2002 (1) SA 396 (SCA); Sharrock, 143–147.

21 *Quinn and Company Ltd v Witwatersrand Military Institute* 1953 (1) SA 155 (T).

22 Fouché, 247; Gibson, 214–218; Havenga et al., 148–149; Sharrock, 142–143.

23 *Keighley Maxsted and Company v Durant* [1901] AC 240.

24 *Edelstein v Edelstein NO* 1952 (3) SA 1 (A) at 10.

25 *McCullogh v Fernwood Estate Ltd* 1920 AD 207; *Nine Hundred Umgeni Road (Pty) Ltd v Bali* 1986 (1) SA 1 (A).

26 Companies Act 71 of 2008.

27 Close Corporations Act 69 of 1984.

28 Trust Property Control Act 57 of 1988; *Simplex (Pty) Ltd v Van Der Merwe and others NNO* 1996 (1) SA 111 (W).

29 *Collen v Rietfontein Engineering Works* 1948 (1) SA 413 (A) at 430.

30 *Theron v Leon* 1928 TPD 723.

31 *Reid v Warner* 1907 TS 961; *Dreyer v Sonop Bpk* 1951 (2) SA 392 (O).

32 Fouché, 250–252; Gibson, 225–231; Havenga et al., 149–150.

33 *Le Clus (Pty) Ltd v Kearney* 1946 CPD 389.

34 *Samuels v Jacobs and Company* 1928 AD 356.

35 *R v Milne and Erleigh* 1951 (1) SA 791 (A) at 828.

36 *Transvaal Cold Storage Company v Palmer* 1904 TS 4.

37 Sharrock, 140.

38 *Levin v Levy* 1917 TPD 702; *Durand v Louw* 1935 TPS 47.

39 *Hansa v Dinbros Trust (Pty) Ltd* 1949 (2) SA 513 (T).

40 Fouché, 252; Gibson, 231–237; Havenga et al., 150–151.

41 *Karol v Fiddel* 1948 (4) SA 466 (C).

42 *Barnabas Plein and Company v Sol Jacobson* 1928 AD 31.

43 *Hersov and Company v Spitz* 1927 TPD 938.

44 *Mosenthal and Company v Gruskin* 1922 EDL 47.

45 *Thomson Watson and Company v Poverty Bay Farmers' Meat Company Ltd* 1924 CPD 380.

46 *Blumenthal v Bond* 1916 AD 37.

47 *Treasurer General v Van Vuuren* 1905 TS 590.

48 Fouche, 252–253; Sharrock, 150–152.

49 *Cullinan v Noordkaaplandse Aartappelkernmoerkwekers Koöperasie Bpk* 1972 (1) SA 761 (A).

50 Sharrock, 150–152.

51 *Durity Alpha (Pty) Ltd v Vagg* 1991 (2) SA 840 (A).

52 *M and C Finance (Pty) Ltd v Segalo* 1994 (1) SA 233 (O).

53 *Stafford t/a Natal Agricultural Co v Lions River Saw Mills (Pty) Ltd* 1999 (2) SA 1077 (N); *SA Metal and Machinery Co (Pty) Ltd v Klerck NO and others* [2005] 1 All SA 44 (E).

54 Sharrock, 152.

55 *Springfield Omnibus Service Durban CC v Peter Maskell Auction CC and another* 2006 (4) SA 186 (N).

56 Fouché, 248–249; Gibson, 218–225.

57 Estate Agency Affairs Act 112 of 1976.

58 *Gluckman v Landau and Co* 1944 TPD 261; *Brayshaw v Schoeman* 1960 (1) SA 625 (A).

59 *Eileen Louvet Real Estate (Pty) Ltd v AFC Property Development Co (Pty) Ltd* 1989 (3) SA 26 (A) at 30H.

60 *Wachs v Record* 1955 (2) SA 234 (C); *Brayshaw v Schoeman* 1960 (1) SA 625 (A).

61 *Aida Real Estate Ltd v Lipschitz* 1971 (3) SA 871 (W).

62 *Naidu v Naidoo* 1967 (2) SA 223 (N); *Commercial Business Brokers v Hassen* 1985 (3) SA 583 (N).

63 *Barnard and Parry Ltd v Strydom* 1946 AD 931; *Lombard v Reed* 1948 (1) SA 30 (T).

64 *Barnard and Parry Ltd v Strydom* 1946 AD 931.

65 *Vanarthdoy (Edms) Bpk v Roos* 1979 (4) SA 1 (A).

66 *Webranchek v L K Jacobs and Company Ltd* 1948 (4) SA 671 (A); *Aida Real Estate Ltd v Lipschitz* 1971 (3) SA 871 (W).

67 *Aida Real Estate Ltd v Lipschitz* 1971 (3) SA 871 (W).

68 *Chiappini and Co v Jaffray's Trustees* (1841) 2 Menz 192.

69 *Marcus v Stamper and Zoutendijk* 1910 AD 58.

70 *Dely and De Kock v Civil Commissioner* 1906 TS 94; *Marcus v Stamper and Zoutendijk* 1910 AD 58; *R v Le Roux* 1959 (1) SA 808 (T).

71 Gibson, 218–225.

72 Administration of Estates Act 66 of 1965.

73 *Wood v Visser* 1929 CPD 55.

74 Fouché, 253; Gibson, 237–243; Havenga et al., 151–152; Sharrock, 140–141.

75 *Natal Trading and Milling Company Ltd v Inglis* 1925 TPD 724.

76 *Edelson v Glenfields Estates (Pty) Ltd* 1955 (2) SA 527 (E).

77 Fouché, 253–254; Gibson, 243–244; Havenga et al., 149; Sharrock, 140–141.

78 *Koch v Mair* (1894) 11 SC 71; *Stableford and Co v Brady* (1902) SC 490; *Price Bros and Barnes Ltd v Snyman* 1936 TPD 332; *Ex parte Kelly* 1943 OPD 76; *Glover v Bothma* 1948 (1) SA 611 (W); *Anglo Carpets (Pty) Ltd v Snyman* 1978 (3) SA 582 (T) at 585H; *Consolidated Frame Cotton Corporation Ltd v Sithole* 1985 (2) SA 18 (N).

79 *Macfarlane and Jennings NO v Dadamia* 1941 WLD 148.

80 *National Board (Pretoria) (Pty) Ltd v Swanepoel* 1975 (3) SA 16 (A).

81 *Kotze and Nell v Benjamin* 1929 TPD 930.

82 *Van Niekerk v Van Noorden* (1900) 17 SC 63; *Natal Bank Ltd v Natorp and Registrar of Deeds* 1908 TS 1016; *Du Plooy's Trustee v The Netherlands Bank* 1913 TPD 522; *Leith NO and Heath NO v Fraser* 1952 (2) SA 33 (O) at 35; Sharrock, 141.

83 *Natal Bank Ltd v Natorp and Registrar of Deeds* 1908 TS 1016.

84 *National Board (Pretoria) (Pty) Ltd v Swanepoel* 1975 (3) SA 16 (A).

85 *Ex parte Lubbers* 1937 TPD 113; *Ex parte Kelly* 1943 OPD 76.

86 *Tucker's Fresh Meat Supply (Pty) Ltd v Echakowitz* 1958 (1) SA 505 (A) at 511H.

87 *McEween NO v Hansa* 1968 (1) SA 465 (A) at 470H; *Goodricke and Son v Auto Protection Insurance Co Ltd (In Liquidation)* 1968 (1) SA 717 (A).

Chapter 23

Employment

'Labour was the first price, the original purchase – money that was paid for all things. It was not by gold or by silver, but by labour, that all wealth of the world was originally purchased.'

ADAM SMITH (1723–1790)
SCOTTISH PHILOSOPHER AND ECONOMICS AUTHOR

What is covered in this chapter

1 Letting and hiring
2 Formalities required for a contract of employment
3 Relationship between the parties
4 Liability for delicts
5 Termination of employment
6 Remedies for termination
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Most people earn a weekly wage or monthly salary by working for an employer; some people run their own businesses and employ other people to work for them. Either way, each of us spends most of our daily lives thinking about work, preparing for work, getting to and from work, and working.

It is therefore vital that we understand the law regarding employment, and the rights and duties of employers and employees. What are the differences between an independent contractor and an employee? What are the minimum conditions of employment? When is an employer liable for negligent or wrongful acts committed by the employee? How can employment be terminated fairly, and what remedies are there when employees are dismissed unfairly?

1 Letting and hiring

South African law of employment developed from the Roman law classification of the law of letting and hiring. There were three categories:[1]

- **Law of letting and hiring of services**:[2] Labour law regulates the relationship between an employer and an employee, and is only concerned with labour performed by the employee under the control and supervision of the employer.
- **Law of letting and hiring of work**:[3] An independent contractor is hired to perform a piece of work. For example, install a swimming pool. The employer and independent contractor negotiate as equals on an equal footing and do not need the protection offered by labour law.
- **Law of letting and hiring of things**:[4] The law of lease.

1.1 Letting and hiring of services – an employee

This is the ordinary contract of employment. The employee puts his or her services at the disposal of the employer. The employee operates under the authority, control, and supervision of the employer. The employer prescribes what work is to be done, and how, when, and where it should be performed.[5]

It is possible to be an unpaid employee. Remuneration is not an essential component of the contract of employment.[6]

The employer must provide the employee with the tools required to perform the work. The employee is considered part of the employer's business organisation, and his or her services are rendered on a permanent basis.

The employee is liable for his or her wrongful acts done negligently or intentionally (known as delicts) against third parties. However, in addition, the employer is also jointly and severally ‘vicariously liable’ for the employee's delicts. The doctrine of vicarious liability makes the employer responsible for a lack of care on the part of an employee in relation to those

to whom the employer owes a duty of care. The delicts must be committed by the employee in the course of the services being performed, or in seeking to advance the interests of the employer.

1.2 Letting and hiring of work – an independent contractor

This is a work acceptance contract. The independent contractor undertakes to perform a certain job, but does not operate under the control and supervision of the employer. The independent contractor uses his or her own tools and discretion regarding the how and when of doing the job. The means of achieving the task are left entirely up to him or her. The independent contractor does not operate under the employer's orders, except in ensuring that the end product is acceptable to the employer.[7]

The independent contractor is not considered part of the employer's business organisation. Normally his or her services are rendered for a specific piece of work. Where professional services are rendered, for example by attorneys, a contract of mandate is created (one person gives a mandate to another to do something on his or her behalf) and not a work acceptance contract.

The independent contractor is personally liable for delicts committed against third parties in the course of performing the contract.

1.3 Distinguishing between letting and hiring of services, and letting and hiring of work

It is necessary for the parties involved to be able to determine whether a person is contracting to put his or her services at the employer's disposal, or whether he or she is undertaking to supply a product or result. This is because an employee is protected by labour law, whereas an independent contractor is limited to protection under the law of contract.[8]

South African law has developed three possible tests to determine whether the contract is one of letting and hiring of services or letting and hiring of work:[9]

- **The control test**: The greater the degree of control and supervision the employer is able to exercise over the work and its manner of

performance, the more likely it is that the contracting party is an employee.[10]

The employer determines both what must be done, and how. The employee places his or her capacity at the disposal of the employer, who must then decide how to utilise the capacity.[11]

***R v Feun*[12]**

The court held that whether the control exercised is such as to lead to the inference that the person is an employee is a question of degree. The control exercised varies according to the type of employment and therefore the control test may be very limited.

***FPS Ltd v Trident Construction (Pty) Ltd* [13]**

The court considered a situation where a consultant worked for commission only, worked during his own time only, and used his own motor vehicle. However, he was required to carry out all duties assigned to him, comply with the company's policies, submit full reports whenever requested, and join the company pension, medical aid, and accident schemes.

The court held he was an employee due to the degree of supervision and control over him.

- **The organisation test**: Does the person appear to form part of the employer's organisation? This test has been rejected because it is very vague.
- **The dominant impression test**: Where the contract looks like a mixture of letting and hiring of services and of work, it has been held that the dominant impression will prevail. For example, does the employer have the right to discipline? The right to decide the hours of work?[14]

For the purposes of South African common law, the dominant impression test has been held to be the most authoritative test for determining whether a person is an employee or an independent contractor.

The Basic Conditions of Employment Act[15] provides that a person who provides services to any other person can be presumed to be an employee if any one of the following factors is present:

- The manner in which the person works is subject to the control or direction of the employer.

- The person's hours of work are subject to the control or direction of the employer.
- In the case of a person who works for an organisation, the person forms part of the organisation.
- The person has worked for the employer for at least 40 hours per month over the last three months.
- The person is economically dependent on the employer.
- The person is provided with his or her tools of trade or work equipment by the employer.
- The person only works or supplies services to the one employer.

The Code of Good Practice: Who is an Employee?[16] provides guidelines for determining whether people are employees or independent contractors, irrespective of what they may be called in a contract. This helps to ensure that genuine employees are protected by labour law and are not deprived of this protection by dishonest contracting arrangements. In case of any dispute, an employer must prove that the person hired is in fact an independent contractor and not an employee.

Denel (Pty) Ltd v Gerber [17]

A woman who rendered services through her company, Multicare Holdings (Pty) Limited, was held to be an employee and not an independent contractor. Multicare had entered into an agreement with Denel for the provision of personnel management services. The woman had represented to the SA Revenue Services that she was an employee of Multicare, and there was no other person from Multicare that could have performed these functions. Payment occurred by cheques that were made out to Multicare. When Denel terminated the agreement, the woman alleged that she was unfairly dismissed.

The court held that when it is called on to decide whether a person is another's employee or not, it is obliged to determine the true and real position and it ought not to decide the matter exclusively by virtue of what the parties have chosen to say in their agreement. The court noted that the woman performed her duties subject to the control and direction of Denel, worked as part of Denel's organisation, worked for Denel exclusively for a long time, was financially dependent on Denel and was provided with the necessary office and equipment to do her work by Denel. In the circumstances, the court held that in reality the relationship between Denel and Gerber was one of employment.

1.4 Employees and independent contractors

The differences between employees and independent contractors are illustrated in Table 23.1.

2 Formalities required for a contract of employment

Generally, no formalities are required. The contract may be written, oral, or arise through conduct. Exceptions include agreements for apprentices, and candidate attorneys and pupil advocates, where the contracts must be in writing, signed by both parties and registered before they are valid.[18]

Table 23.1 *Employees and independent contractors*

	Employee	**Independent contractor**
Number of employers	Normally works for one employer only.	Can work for many employers or clients.
Place where work is done	Normally works in premises provided by employer.	Can work in own premises or in premises provided by employer.
Membership	Part of employer's organisation.	Not part of employer's organisation.
Remuneration	Receives a salary or wage. Receives a payslip.	Receives payment for work done. Submits an invoice.
Taxation	May have tax and UIF deductions made from salary. Does not qualify to charge VAT. Limited expenses may be deducted for tax purposes.	No tax or UIF deductions. May qualify to charge VAT. Wide range of expenses may be deducted.
Employer contributions to pension and medical schemes	Member of employer schemes. Employer contributes.	Not a member of employer schemes. Employer does not contribute.
Hours of work	Normally decided by employer.	Normally decided by contractor.
Holidays	Paid leave. Dates to be arranged with employer.	No paid leave. Chooses own dates for any vacation.
Sickness	Entitled to sick pay.	Not entitled to sick pay.
Compensation if injured at work	Eligible.	Not eligible.
Legal liability	Both employer and employee will be liable for employee's delicts (i.e. wrongful acts whether intentional or negligent).	Liable for own delicts (i.e. wrongful acts whether intentional or negligent).
Termination	Entitled to minimum notice and protected against unfair dismissal by labour laws.	Entitled to notice as determined by contract. No protection against unfair termination by labour laws. Instead, the law of contract regulates protection against unlawful termination of contract.
Unemployment benefits	Eligible.	May be eligible. Only if contributions have been made and if he or she spends over 75% of his or her time engaged in

		performing tasks for one employer or obtains over 75% of his or her income from one employer.

3 Relationship between the parties

Generally, the employer may select whomever he or she wishes to employ. However, the Basic Conditions of Employment Act[19] prohibits the employment of children less than 15 years of age.

Where the State is the employer, the Constitution[20] applies. The equality provisions of the Constitution mean that the State, acting as an employer, may not discriminate between citizens on the grounds as set out in the Bill of Rights, including culture, creed, sex, age, religion, or sexual orientation. Despite the equality provisions, affirmative-action selections and promotions are constitutional and legal and form part of the Employment Equity Act.[21] The Labour Relations Act[22] extends this protection by providing that job applicants are included under the protection offered to employees.

The employer can stipulate the method by which the work should be done and also has the right to dismiss the employee. By accepting the job, the employee implies that he or she is competent to perform it, undertakes to tender his or her capacity to the employer for a certain period, and to subordinate himself or herself to the employer for the duration of that period.

3.1 Common-law duties of the employer [23]

3.1.1 To pay the employee

Payment must be made punctually and in terms of the employment agreement. Payment of wages must be in legal tender or in kind, or a combination of both.[24]

Under the common law, and in the absence of an agreement to the contrary, if the employee had not worked for any reason (for example, illness) he or she was not entitled to be paid at all. Hence the saying ‘no work, no pay’.

Under the common law, the employer must pay the employee up to the time that he or she leaves employment. Where the employee deserts his or her employer, he or she must be paid only up to the time when he or she left.[25] Where the employee is suspended, he or she is entitled to full remuneration during the suspension. Where the employee is subsequently dismissed, he or she must be paid up to the time of dismissal.[26]

Provided that the employer has written authorisation from the employee in accordance with the Basic Conditions of Employment Act,[27] the employer may set off debts owed to him or her by the employee. The normal rules of set-off apply. In the absence of written authorisation, the employer may not make any deductions of any kind from remuneration owed to the employee. The employer must follow a fair procedure. The total amount of the deduction may not be more than one quarter of the employee's remuneration.

Death of the employer does not necessarily terminate the employment contract. The estate of the employer remains bound to pay the agreed wage to the end of the agreed term. However, the employee has a duty to mitigate the loss by accepting another job.

The contract automatically terminates on the death of the employee, due to impossibility of performance.

Insolvency of the employer suspends the contract of employment. It is then up to the trustee to consult with employees; the trustee may decide to terminate their employment or to select some employees for continued employment to keep the business running. In the absence of an agreement,

employment contracts not already terminated will terminate 45 days after the appointment of the final trustee.

3.1.2 To provide safe and healthy working conditions

It is the duty of both employer and employee to diminish or eliminate the dangers of certain types of work. For example, the employer must ensure that machinery is in good order and provide protective clothing; the employee must obey safety rules and be careful when using dangerous equipment.

The Compensation for Occupational Injuries and Diseases Act[28] absolves employers who contribute to the Compensation Accident Fund from liability for workplace diseases and injuries. That means the Fund will pay the employee compensation for injury, and the employee will not be able to sue the employer. Employers who do not contribute to the Fund remain personally liable.

In terms of the common law, the employer did not need to provide sick leave or annual leave. Employees were not entitled to any sick leave or annual leave unless expressly provided for in the contract of employment, or under legislation. The employee was not entitled to leave pay on termination of his or her services for leave due but not taken.[29]

Under the common law, where the contract provided for annual leave, it could be taken only after the employee had worked for a full year. If he or she left the employer before the year was completed, he or she was not entitled to any leave.[30]

However, the common-law position has been changed by the Basic Conditions of Employment Act.[31] The details of this Act are discussed later in this text in chapter 24 on labour legislation.

3.1.3 To provide work for the employee

The general rule is that an employer does not commit a breach of contract if he or she fails to provide work for an employee to do, provided the employer pays the employee the salary agreed upon.

In the following exceptions, the employer will commit a breach of contract if the employer fails to provide work for the employee:

- Where the employee's remuneration consists of piecework, a commission, or a share of profits.
- Where an employee's earning capacity is linked to the publicity he or she gets from the work (for example, an actor), or where a person must regularly practise his or her profession to retain his or her skill (for example, a professional football player).
- Where the employer undertakes to instruct and train the employee. For example, an apprentice, candidate attorney, or advocate pupil.

The employer also may not force the employee to work for another employer without the prior agreement of the employee.

3.1.4 Not to make the employee carry out work junior to the status for which the employee was employed

The employer may not force the employee to carry out work that is different from the work specifically agreed upon.[32] Parties may agree to alter the type of work to be done. For example, by promotion, demotion, or transfer. A new contract will then come into being and extinguish the original contract.

3.2 Common-law duties of the employee[33]

3.2.1 To make his or her personal services available

The employee must place his or her capacity to work at the disposal of the employer in accordance with the requirements of the contract of employment. The employer cannot force the worker to perform work other than that agreed upon, but, as discussed above, subsequently may form a new agreement with the employee. For example, a promotion, demotion, or transfer.

3.2.2 To perform the work faithfully, diligently, and competently, and to subordinate himself or herself to the employer

By accepting the job, the employee warrants that he or she is competent to perform the work required. Sufficiently serious incompetence and negligence are both grounds for terminating the contract.

Showing contempt to an employer, if serious, could amount to a breach of contract. For example, writing an offensive comment about an employer on Facebook, or using abusive language to a client of the employer.

3.2.3 To obey reasonable orders given in the normal course of employment

Refusal by the employee, in the absence of a good reason to carry out the employer's instructions about the work to be done, constitutes a breach of contract. It is not a breach of contract to refuse to work overtime, unless there is an agreement to work overtime.

3.2.4 To act in good faith

The employee must protect the interests of the employer by all reasonable means in his or her power. This means that he or she should not harm the business interests of the employer or divulge to any competitor any confidential information about the employer's enterprise. These acts would violate the duty of good faith. Competition by the employee with the employer also amounts to a violation of the relationship of trust. The employee must be honest with the employer. Examples of breaches of the duty to act in good faith include theft of the employer's property and fraud committed against the employer.

The employee should not use the employer's property for himself or make unauthorised use of it for his own business.

Anglo American Farms t/a Boschendal Restaurant v Komjwayo[34]

A waiter was summarily dismissed for stealing a can of cooldrink.

The court held that for a healthy relationship to exist between an employer and an employee, the employer must be able to trust the employee not to steal stock. If that confidence is diminished or destroyed, the employer is justified in finding that the continuation of the employment relationship is intolerable.

De Beers Consolidated Mines Ltd v CCMA and others[35]

The court held that dismissal is not ‘an expression of moral outrage’ or ‘an act of vengeance’. It should be a sensible operational response to risk management in the particular enterprise. That is why supermarket shelf packers who steal small items are routinely dismissed. Their dismissal has little to do with society's moral disapproval of a minor theft; it has everything to do with the operational requirements of the employer's enterprise.

The employee should use his or her working hours to further the interests of the employer. This means that he or she should not during working hours perform work for another employer or conduct unauthorised business, or conduct other activities that prevent him or her from carrying out work duties.

3.2.5 To conduct himself or herself properly

It is the duty of an employee to conduct himself or herself in accordance with the accepted practice and policy of the employer. Gross misconduct may lead to ‘summary dismissal’ (immediate dismissal without notice). The employee may not use confidential information, such as lists of his or her previous employer's customers and their particulars.[36]

Confidential information disclosed to an employee must not be disclosed to any third party. An employee is similarly not entitled to use his or her position to make a secret profit.[37]

Gerry Bouwer Motors (Pty) Ltd v Preller **[38]**

A car salesman was summarily dismissed after his employer found that he was being paid by an insurance company to have customers place insurance with that company.

The court held that his acceptance of the gifts and money without informing his employer was proof of his dishonesty and unfaithfulness.

4 Liability for delicts

The liability of an employer for wrongful acts or omissions (whether intentional or negligent) committed by the employee is known as ‘vicarious liability’.[39]

The general rule is that no one can be held responsible for the unlawful or wrongful actions of another. However, employers can be held liable for the wrongful delicts committed by employees, together with the employee, if the employee acted in the exercise of his or her duties in terms of the contract and towards the promotion of the interests of the employer. The aggrieved party may sue either the employee or the employer, or both of them.

For an employer to be vicariously liable for the delicts of the employee, the following two elements must be proved:

4.1 There must be an employment relationship

It is vital to distinguish between an independent contractor and an employee. The employer generally is not liable for delicts of an independent contractor acting under his or her authority, but not his or her control.

However, it is sometimes possible for an employer to be held vicariously liable for the delicts committed by independent contractors. The existence of a duty to take steps to prevent harm to the public will depend on the facts of each case. Relevant factors to consider would include the nature of the danger, the context in which the danger may arise, the degree of expertise available to both the employer and the independent contractor, and the means available to the employer to prevent the danger.

There are three requirements to prove for an employer to be liable for delicts committed by an independent contractor:

- Would a reasonable employer have foreseen the risk of danger as a consequence of the work the independent contractor was required to perform?

- Would a reasonable employer have taken steps to guard against the danger?
- Were these steps taken or not?

Langley Fox Building Partnership (Pty) Ltd v De Valence[40]

The main contractor on a building site, and the employer of a subcontractor, was sued for loss of future earning capacity when a member of the public hit her forehead against a wooden beam suspended over the sidewalk. The beam had been placed there by the subcontractor. No warning signs had been erected and the area had not been cordoned off.

The court found that such an obstruction on a sidewalk was inherently dangerous and the employer should have foreseen the danger. The employer was not entitled to simply leave it to the subcontractor to take steps to protect the public against the danger.

4.2 Course and scope

The delict must have been committed by the employee in the course and scope of the performance of his or her duties, and in seeking to advance the interests of the employer.

The employer will be liable for any wrongful acts committed by an employee that were undertaken to give effect to the instructions of the employer or to further the interests of the employer. The employer similarly will be liable for an act expressly forbidden by the employer, or for an act committed outside of the fixed working hours of the employee, where the employee acts in the execution of his or her duties and within the scope of his or her contract of service.

Feldman (Pty) Ltd v Mall [41]

A driver was instructed to return to work immediately after his delivery. Instead, he spent some time visiting friends at their residence. On returning to work he ran over and killed a person.

The court found the employer vicariously liable because the employee, at that stage, had resumed his duties and was returning to work.

Minister of Police v Rabie[42]

The court held that the determination of whether an employee acted within the scope of employment incorporates both a subjective and an objective enquiry.

An act by a servant that is done solely for his own interest and purposes may fall outside the course and scope of his or her employment. Reference must be made to the

servant's intention. The test is in this regard subjective. On the other hand, if there is still a sufficiently close link between the servant's acts for his own interests and purposes and the business of his master, the master may yet be liable. This is an objective test. The master will be liable even for acts which he or she has not authorised provided that they are so connected with an act which was authorised that they may be regarded as modes – although improper modes – of doing them.

The test applied by the courts in determining the vicarious liability of an employer is whether or not the action of the employee was such that it could be said that he or she had completely severed himself or herself from the employer's interests. Even if the employee's actions were partially to further the employer's interests, the employer may be held liable.

Bezuidenhout NO v Eskom [43]

A driver of a vehicle fell asleep at the wheel, and his hitchhiker passenger was severely injured while on the way to a festival. The driver was an employee of Eskom, and had been expressly forbidden to give any person a lift in the vehicle that had been provided for work purposes.

Eskom conceded the negligence of the employee but denied that, at the time of the accident, he had been driving within the course and scope of his employment.

The court considered the application of the standard test for vicarious liability as set out in *ab initio*. This test has both a subjective element and an objective element: The subjective element is whether the state of mind of the employee indicates that the employee had disassociated himself from his employment. The objective element is whether there is a sufficiently close link between the employee's acts in the employee's own interest and purposes and the business of the employer for vicarious liability to be established.[44]

The court held that the employee had known he was prohibited from giving the hitchhiker a lift and had no intention of furthering Eskom's affairs by doing so and consequently the subjective test was not satisfied. Further, the hitchhiker's presence had made no contribution whatsoever to the furthering of the business of Eskom and consequently the ‘close connection’ required by the objective test was absent.

The court held that because the requirement relating to unauthorised passengers created a limitation on the scope of employment, and was not merely an instruction as to the manner of performing the employer's business, the conclusion that the negligent driving of a vehicle carrying a passenger exceeded the bounds of the driver's employment was unavoidable. The giving of the lift was an act of a class that the driver was not employed to perform at all. The court held that Eskom was not vicariously liable.

5 Termination of employment[45]

5.1 Expiry of term of service

If a contract is for a fixed term only, then employment is terminated when the period specified in the employment contract comes to an end.

5.2 Notice of termination

In terms of the common law, and in the absence of express contractual terms, notice must be reasonable. But what is reasonable? Reasonableness was determined by the common law from the frequency of payment to employees:

- **Paid monthly**: One month's notice, given on the first day of the month.[46]
- **Paid weekly**: One week's notice.[47]
- **Daily rate, but paid weekly or monthly**: One day's notice.[48]
- **Casual or daily labourer**: No notice required.[49]
- **Yearly contract**: Three months' notice.[50]

The common law provided that notice did not have to be in writing.[51] Normally, it was to be given to the party in person, but if that party was absent from work, it was acceptable to serve notice by posting a registered letter to the residential address. The notice had to be given at the beginning of the pay period.[52] Notice could be given during periods of sick leave or annual leave.[53] Notice had to be categorical and not conditional. The requirement of notice could be waived only by mutual consent of both parties. The courts would not accept a waiver of notice unless mutual consent could be proved.[54]

However, the common-law rules have been modified by the Basic Conditions of Employment Act.[55] Notice to literate employees must be in writing. Notice may not be given to an employee during sick leave or annual leave to which he or she is entitled.

Generally with regard to termination of employment, during the first six months of employment, only one week's notice must be given by either party. After six months, the minimum notice becomes two weeks. After one year of employment, notice is four weeks. A farmworker or domestic worker is entitled to a minimum of four weeks' notice after only six months of employment.

If the employee has previously worked for the same employer, then the previous period of employment must be taken into account in determining the length of service, provided that the break between periods of employment was less than one year.

5.3 Resignation

An employee can unilaterally terminate a contract of employment by resignation. This is a unilateral act that does not require acceptance by the employer. On the other hand, the withdrawal of a resignation is effective only if agreed to by both parties.[56]

Mafika v South African Broadcasting Corporation Ltd [57]

An employee was told that he would be suspended and face a disciplinary enquiry. He sent an SMS to his employer saying that he ‘quit with immediate effect’. After some thought, he later decided that it would be better to face the disciplinary inquiry and clear his name. Six weeks later he sent a letter to his employer saying that it should proceed with the disciplinary inquiry. One week later the employer sent him a copy of the letter they had unsuccessfully tried to send to him the month before, saying that his resignation was accepted. The employee claimed his resignation was not in writing, and that he had withdrawn it before his employer had accepted it.

The court held that the employee had validly resigned. The Electronic Communications and Transactions Act[58] allows for a data message to constitute writing, which meant that an SMS is a written resignation. The court also held that a resignation is a unilateral act that does not require acceptance by the employer. On the other hand, the withdrawal of a resignation is effective only if agreed to by both parties.

5.4 Repudiation

Desertion can also be seen as a form of repudiation of employment. Generally, before the employer may terminate the contract, it should take some steps to ascertain the employee's whereabouts, and instruct him or her, by telephone or telegram, to return to work by a particular date.

5.5 Transfer of business

When any business is transferred as a going concern, the employment contracts are also transferred. The rights and obligations of employment must continue, and the employee's continuity of employment is not interrupted. This is provided for in terms of the Labour Relations Act,[59] as discussed in detail in another chapter of this book.

5.6 Insolvency of the employee or the employer

The insolvency of the employee does not affect the contract of employment.[60]

Where an employer is a natural person, and if the estate of the employer is sequestrated, the contract of employment is terminated. The employee has a claim for damages against the insolvent estate for remuneration.

In terms of the Companies Act,[61] during business rescue proceedings involving a financially distressed company all employment contracts remain valid and enforceable. The company may unilaterally cancel or suspend any provision of a contract, except for a contract of employment.

The Insolvency Act[62] provides that if the business is liquidated, all contracts of employment are suspended until the trustee decides whether or not to terminate a particular contract. Until that decision was made the employee would not have to work. The employee would not be paid or be eligible for benefits under the Basic Conditions of Employment Act.[63] However, the employee could make a claim for unemployment benefits immediately from the date of the suspension. The trustee is required to consult with the parties to any applicable collective agreement, workplace forum, or registered trade union, or the affected employee, prior to making any decision to terminate any contract of employment. An employee whose employment was terminated is able to claim severance benefits in accordance with the formula set out in the Basic Conditions of Employment Act.[64]

Where the trustee sells the business because of insolvency, or in terms of an agreement of compromise reached with creditors to avoid the business being wound up or liquidated, the new owner is substituted in place of the old employer in all contracts of employment. Continuity of employment is

uninterrupted. However, all the obligations of the old employer do not transfer to the new employer – the old employer continues to be liable.

5.7 Death of the employer or the employee

The death of an employer does not terminate the contract: the employer's estate becomes the employer.[65]

The employment contract comes to an end if an employee dies. The executor of the deceased estate may claim wages and accrued leave. The employer may not make deductions in lieu of notice or claim damages from the estate.[66]

5.8 By agreement

The employer and the employee may agree to terminate the employment contract.

5.9 Summary dismissal

The employer is entitled to dismiss the employee summarily (immediately without notice) if the employee's actions amount to a repudiation of the contract or render impossible the continuation of the employment relationship. It is harsher than dismissal with notice, and must be resorted to only in the most serious of cases.

Reasons for summary dismissal include:

- **Gross misconduct**: For example, assault, wilful damage to the property of the employer, or wilful endangering the safety of the employer, a co-employee, or a member of the public. The employee has a duty to conduct himself or herself in accordance with the accepted practice and policy of the employer. Serious misconduct amounts to a breach of contract.[67]

  Whether the misconduct warrants dismissal on notice, or summary dismissal, will depend on the seriousness of the misconduct, and the facts of each case.
- **Gross negligence of a serious nature**.[68]

- **Gross incompetence**: At the time of concluding the contract, the employee tacitly guarantees his or her competence. If the employee becomes incapable, he or she is in breach of contract.[69]
- **Dishonesty**: This includes misappropriation of money or goods, failure to account for monies received for the employer, fraud, withholding information, entering into contracts without authority, theft of property, and taking secret commissions or bribes.[70]
- **Gross insolence and rudeness, serious disrespect, insubordination, and assault**: Subordination to the employer distinguishes an employee from an independent contractor. Contempt, if serious, amounts to a breach of contract. For example, writing an offensive letter to the employer, or using rude or offensive language to a client, the employer, or other employees. Insubordination amounts to a subversion of discipline.[71]
- **Disobedience**: This refers to wilful disobedience of a lawful order falling within the scope of the employee's appointed duties. Refusal without good cause to carry out the employer's instructions pertaining to the work to be done gives rise to a breach of contract. Summary dismissal is justifiable only when that breach is material.[72]

  Employees who refuse to carry out unlawful or unreasonable instructions act within their lawful rights and may not be dismissed. Refusal to work overtime in the absence of any agreement to work overtime does not give rise to a breach of contract.
- **Commercial infidelity to employer**: Violation of the duty to act in good faith can in certain cases lead to court actions by the employer. For example, competition by the employee, assisting competitors, revealing trade secrets, and taking secret profits.[73]

  If the private operations of the employee occur during his or her time off and do not in any way damage the business of the employer, the employee is acting within his or her lawful rights.

6 Remedies for termination[74]

Where the contract of employment has been breached, the courts may provide various remedies:

6.1 Damages

Compensation may be awarded in the form of money.

Denel (Pty) Ltd v Vorster [75]

A dismissed employee sued his employer in the High Court for damages for contractual breach of his employment contract. He complained that the process that was followed in dismissing him was not in accordance with the employer's disciplinary code and that his dismissal was accordingly unlawful.

The employer argued that it was entitled to deviate from the disciplinary code by virtue of the right to fair labour practices contained in the interim and final Constitutions. The relationship between an employer and an employee was governed only by the reciprocal duty to act fairly, with the result that contractual terms requiring anything more can be disregarded.

The court held that where there are express contractual terms governing a disciplinary process, it is no defence for an employer to say that the alternative process followed was 'just as good'. The court held that the respondent's dismissal was unlawful.

6.2 Specific performance

A person may be ordered to fulfil his or her contractual obligation. For example, an employer may have to reinstate or re-employ an employee who has been unfairly dismissed. The courts generally will not order specific performance if the breach is serious because:

- The employee may not want to be reinstated or re-employed.
- Circumstances surrounding the dismissal may be such that a continued employment relationship is inappropriate.
- It may not be reasonably practicable for the employer to reinstate or re-employ the employee.
- The dismissal may be unfair only because of an unfair procedure.

Nationwide Airlines (Pty) Ltd v Roediger and another [76]

A pilot resigned by giving one month's notice of termination of employment, instead of three months as stated in his contract. The airline applied to the High Court to enforce the contract.

The court held the following circumstances had to be considered in deciding whether to grant specific performance of an employment contract: (1) The particular relationship between the employer and the employee; (2) The nature of the employment relationship; (3) The nature of the services to be provided; (4) The prejudice to the employer if specific performance was not granted compared to the prejudice suffered by the employee if it was granted.

The court held the pilot was not an ordinary employee; he had negotiated a high salary and contracted on equal terms with the employer. If the order for specific performance was not granted, it would have taken the airline several months to find a replacement pilot, resulting in many cancelled flights at huge cost to the employer. The order for specific performance was granted.

6.3 Interdict

A person may be ordered either to stop a particular activity (for example, to discontinue excessive overtime), or to commence a particular activity (for example, to perform work as agreed upon).

PRACTICALLY

SPEAKING

Ten things to include in an employment contract[77]

Employment contracts take different forms. All employees at a company may be asked to sign the same standard form of contract, or each employee may have a contract with the employer that is applicable to his or her employment agreement.

An employer and an employee may have an oral agreement regarding the kind of work the employee will do, for how long, and at what rate of pay. Sometimes there is no written or oral agreement but the behaviour of the employer and the employee can be viewed as an implied employment contract. Most employment contracts have common elements such as the employee's start date, salary, and benefits.

Other provisions that often appear in employment contracts are listed below. You can think about what kind of employment contract is agreeable to you before you sign your next employment agreement. Your attorney can advise you about the pros and cons of agreeing to the various provisions or suggest other terms to include:

1 **Confidentiality agreement**. An employee confidentiality agreement is a contract or part of a contract in which the employee promises never to share any information about the details of how the employer's business is conducted, or the employer's secret processes, plans, formulas, data, or machinery used, such as the price the company has charged for its products. Usually a confidentiality agreement lasts even after the employee no longer works for the employer.

2 **Restraint of trade clause**. The employee agrees that for a certain amount of time after he or she stops working for the employer, the employee will not work for a rival company or any company engaged in a similar type of business, and the employee will not set up a company that will compete with the employer's business or solicit the employer's customers. Usually the restraint is limited for a specific time period to a particular geographic area.

3 **Ownership of inventions**. This provision applies to employees who invent things as part of their jobs. In this part of the contract the employee agrees that anything he or she invents at work, or during a set period of time after termination, becomes the employer's invention, not the employee's own invention. Additionally, employees usually agree to assign their inventions to the employer, cooperate with the employer in getting inventions patented, and keep information about the invention confidential like any other trade secret. In return, sometimes the employer agrees to share with employee-inventors a percentage of the royalties paid for inventions.

4 **Best efforts**. Although it is often just assumed that the employee will work hard for the employer, sometimes employers add a best-efforts provision to the employment contract. It states that the employee promises to work to the best of his or her ability and to be loyal to the employer. Sometimes it also states that the employee specifically agrees to make suggestions and recommendations to the employer that will benefit the company.

5 **Exclusive employment**. In this provision, the employee promises that as long as he or she works for the company the employee will not work for anyone else in the same or similar type of business. It may also extend to a promise not to be a shareholder or director in a similar business, or even to provide services voluntarily to a similar or competitor business.

6 **No additional compensation**. The no additional compensation clause states that if the employee becomes an elected director or officer of the company or serves on a company managing committee, the employee will not be entitled to additional compensation for doing that work.

7 **No authority to contract**. Sometimes this part of the contract is called the ‘agency’ provision. It makes it clear that the employer and employee have an employment relationship only, not an agency relationship. The employee has no right to enter into a contract or otherwise obligate the employer, unless the employer gives express written consent to do so.

8 **Termination**. A standard part of any employment contract is the termination clause. It states that either party may terminate the employment contract for any reason by giving a certain amount of notice, such as two weeks' notice. It may also give the employer the right to just terminate the contract without notice if the employee violates the contract in any way. Another aspect of the termination clause is a statement that the employer has the right to terminate the contract if the employee can no longer do the job due to permanent disability.

9 **Arbitration**. Arbitration clauses are found in many types of contracts, including employment contracts. In this provision, the parties agree at the onset of the relationship that if they ever have a dispute about any aspect of the employment relationship, they will submit the dispute to arbitration rather than seek resolution by a court of law. It may include details about the arbitration, such as whether the arbitration decision will be binding and how the parties will find an arbitrator when the time comes.

10 **Choice of law**. Employment laws vary from country to country. Some countries have laws that are generally viewed as more favourable or beneficial to employers than

employees or *vice versa*. This part of the contract is an agreement that if the parties ever have a dispute that results in a lawsuit, it will be governed by the laws of the nominated country, no matter where legal action is launched.

THIS CHAPTER IN ESSENCE

1. Our law distinguishes between employees and independent contractors. An independent contractor undertakes to perform a certain job, but does not operate under the control and supervision of the employer. The dominant impression test is the most authoritative test for determining whether a person is an employee or an independent contractor. The Basic Conditions of Employment Act also provides factors that indicate whether a person is an employee.
2. Common-law duties of the employer are: to pay the employee; to provide safe and healthy working conditions; to provide work for the employee; and not to make the employee carry out work junior to the status for which the employee was employed.
3. Common-law duties of the employee are: to make his or her personal services available; to perform the work faithfully, diligently, and competently, and to subordinate himself or herself to the employer; to obey reasonable orders given in the normal course of employment; to act in good faith; and to conduct himself or herself properly.
4. Generally, no one can be held responsible for the unlawful or wrongful actions of another. However, employers can be held liable for the wrongful delicts committed by employees, together with the employee, if the employee acted in the exercise of his or her duties in terms of the contract and towards the promotion of the interests of the employer. The aggrieved party may sue either the employee or the employer, or both of them.
5. Resignation by an employee is a unilateral act that does not require acceptance by the employer. On the other hand, the withdrawal of a resignation is effective only if agreed to by both parties.

QUESTIONS

Short questions (1–5 marks)

1. What is vicarious liability?

2. What is summary dismissal?
3. List the three Roman law categories of the law of letting and hiring.
4. Identify five different ways that employment may be terminated.

Paragraph questions (5 marks)

1. Identify what elements must be proved before the employer may be held vicariously liable for delicts committed by the employee.
2. Provide examples where summary dismissal may be justified.
3. Discuss the differences between the letting and hiring of services, and the letting and hiring of work.

Essay questions (10 marks)

1. Discuss the differences between employees and independent contractors.
2. Discuss the common-law duties of the employer and employee.
3. Discuss the liability of an employer for delicts committed by an employee.

Problem question (20 marks)

1. John is employed by a law firm to deliver packages, documents and letters by bicycle. One evening he breaks his leg playing football and the following day, when his employer hears of this, he is dismissed. After his dismissal, it is discovered that he has regularly been taking money for himself that he pretended to collect from customers on behalf of his employer. What are John's legal remedies?

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1 Fouché, 145; Gibson, 131.

2 The Latin term for the letting and hiring of services is *locatio conductio operarum.*

3 The Latin term for the letting and hiring of work is *locatio conductio operis.*

4 The Latin term for the letting and hiring of things is *locatio conductio rei.*

5 Fouché, 146–147; Swanepoel et al., 133–135.

6 *Rodrigues v Alves* 1978 (4) SA 834 (A).

7 *R v Amca Services Ltd* 1959 (4) SA 207 (A); Fouché, 147; Swanepoel et al., 135–136.

8 *Smit v Workmen's Compensation Commissioner* 1979 (1) SA 51 (A).

9 Gibson, 609–611; Sharrock, 389; Swanepoel et al., 132–133.

10 *Colonial Mutual v MacDonald* 1931 AD 433; *Mhlongo v Minister of Police* 1978 (2) SA 551 (A).

11 *Padayachee v Ideal Motor Transport* 1974 (2) SA 565 (N).

12 *R v Feun* 1954 (1) SA 58 (T) at 61.

13 *FPS Ltd v Trident Construction Pty) Ltd* 1989 (3) SA 537 (A).

14 *Ongevallekommissaris v Onderlinge Versekeringsgenootskap AVBOB* 1976 (4) SA 446 (A).

15 Basic Conditions of Employment Act 75 of 1997.

16 *Code of Good Practice: Who is an Employee*? *Government Notice* 1774 in *Government Gazette* 29445/1-12-2006.

17 *Denel (Pty) Ltd v Gerber* [2005] 9 BLLR 849 (LAC); [2005] JOL 14766 (LAC).

18 Gibson, 611–612; Sharrock, 392.

19 Basic Conditions of Employment Act 75 of 1997.

20 Constitution of the Republic of South Africa, 1996.

21 Employment Equity Act 55 of 1998.

22 Labour Relations Act 66 of 1995.

23 Fouché, 149, 151–152; Swanepoel et al., 139–143; Sharrock, 412–425.

24 *R v Bosch* 1932 EDL 235.

25 *Muller v Grobbelaar* 1946 OPD 272.

26 *Gladstone v Thornton's Garage* 1929 TPD 116.

27 Basic Conditions of Employment Act 75 of 1997.

28 Compensation for Occupational Injuries and Diseases Act 130 of 1993.

29 *Boyd v Stuttaford and Company* 1910 AD 101; *East London Municipality Council v Thompson* 1944 AD 56.

30 *Carstens v Ferreira* 1954 (4) SA 704 (T).

31 Basic Conditions of Employment Act 75 of 1997.

32 *Smith v Cycle and Motor Trade Company* 1922 TPD 324.

33 Fouché, 153–154; Gibson, 616–619; Sharrock, 402–412; Swanepoel et al., 144–147.

34 *Anglo American Farms t/a Boschendal Restaurant v Komjwayo* (1992) 13 ILJ 573 (LAC).

35 *De Beers Consolidated Mines Ltd v CCMA and others* [2000] 9 BLLR 995 (LAC).

36 *Pelunsky and Company v Teron* 1913 WLD 34.

37 Sharrock, 411–412.

38 *Gerry Bouwer Motors (Pty) Ltd v Preller* 1940 TPD 130.

39 Gibson, 620; Swanepoel et al., 151–155.

40 *Langley Fox Building Partnership (Pty) Ltd v De Valence* 1991 (1) SA 1 (A).

41 *Feldman (Pty) Ltd v Mall* 1945 AD 733.

42 *Minister of Police v Rabie* 1986 (1) SA 117 (A).

43 *Bezuidenhout NO v Eskom* 2003 (3) 83 SA (SCA).

44 *Minister van Veiligheid en Sekuriteit v Japmoca BK* 2002 (5) SA 649 (SCA) at 659 B–F.

45 Fouché, 161; Gibson, 624–627; Swanepoel et al., 147–149.

46 *Tiopaizi v Bulawayo Municipality* 1923 AD 317.

47 *Begbie v Hartman* 1925 TPD 455.

48 *Central SA Railways v Cook* 1904 TS 553.

49 *Pretoria City Council v Minister of Labour* 1943 TPD 238.

50 *Tiopaizi v Bulawayo Municipality* 1923 AD 317.

51 Sharrock, 312.

52 *Pemberton v Kessel* 1905 TS 1704; *Tiopaizi v Bulawayo Municipality* 1923 AD 317.

53 *Carstens v Ferreira* 1954 (4) SA 704 (T).

54 *MacFarlane v Crooke* 1951 (3) SA 256 (C); *Weinder Properties v Gutstein* 1952 (4) SA 271 (C).

55 Basic Conditions of Employment Act 75 of 1997.

56 *Mafika v South African Broadcasting Corporation Ltd* [2010] 5 BLLR 542 (LC).

57 Ibid.

58 Electronic Communications and Transactions Act 25 of 2002.

59 Labour Relations Act 66 of 1995.

60 Fouché, 161.

61 Companies Act 71 of 2008.

62 Insolvency Act 24 of 1936.

63 Basic Conditions of Employment Act 75 of 1997.

64 Ibid.

65 *Boyd v Stuttaford* 1910 AD 114.

66 *Robinson v Davidson* (1871) LR 6 EXL 274.

67 *Schneier and London Ltd v Bennett* 1927 TPD 346.

68 *Wallace v Rand Daily Mail* 1917 AD 482.

69 *Friedlander v Hodes Brothers* 1944 CPD 169.

70 *Field v Grace* 1911 CPD 949.

71 *Flemmer v Ainsworth* 1910 TS 89.

72 *Denny v SA Loan Company* (1883) 3 EDC 58; *Taylor v Ward* (1903) 9 HCC 263.

73 *Angehrn and Piel v Federal Cold Storage Company Ltd* 1908 TS 761; *Gerry Bouwer Motors (Pty) Ltd v Preller* 1940 TPD 130; *Premier Medical and Industrial Equipment v Winkler* 1971 (3) SA 866 (T).

74 Fouché, 157; Gibson, 621–624; Swanepoel et al., 149–151.

75 *Denel (Pty) Ltd v Vorster* [2005] 4 BLLR 313 (SCA); [2004] JOL 12535 (SCA).

76 *Nationwide Airlines (Pty) Ltd v Roediger and another* 2008 (1) SA 293 (W).

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Chapter 24

Labour legislation

'I believe in the dignity of labour; whether with head or hand; that the world owes no man a living but that it owes every man an opportunity to make a living.'

JOHN D. ROCKEFELLER (1839–1937)
AMERICAN OIL INDUSTRIALIST, INVESTOR, AND PHILANTHROPIST

What is covered in this chapter

1 Basic Conditions of Employment Act
2 Occupational Health and Safety Act
3 Unemployment Insurance Act
4 Unemployment Insurance Contributions Act
5 Skills Development Act
6 Skills Development Levies Act
7 Compensation for Occupational Injuries and Diseases Act
8 Labour Relations Act
9 Employment Equity Act
10 Protected Disclosures Act
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Sometimes bad things happen to people at work. Employees can be exploited and work under terrible conditions, poor working conditions can cause disease, or people can be treated unfairly or even fired. Our law provides certain minimum standards of protection in employment. Both employers and employees have rights and duties. As either an employee or an employer it is vital that we understand what the minimum standards are to ensure that people are treated properly at work.

We also need to understand some basic things about the world of work: What compensation is there for an employee who is injured at work, or travelling to or from work, or who gets a disease caused by unhealthy working conditions? What are the rights of unemployed people? What do employers and employees have to do to ensure that the workplace is safe to work in? The common law has been changed by several statutes; it is important that you understand these changes.

Importantly, there are also legal obligations on employers to develop their employees and to provide forms of affirmative action to ensure that the workplace is sufficiently representative of all sectors of our society. Employment equity is controversial, but it is here to stay. It is important for employers and employees to understand their rights, particularly if they are affected by a decision to employ or promote another person ahead of them.

1 Basic Conditions of Employment Act

The Basic Conditions of Employment Act[1] (BCEA) lays down minimum and maximum standards that must be complied with by an employer.

The Act applies to all employers and employees except for members of the National Defence Force, the National Intelligence Agency, the South African Secret Service; and unpaid volunteers working for charitable organisations.

If a labour broker (temporary service provider) breaches a provision of the Act, both the labour broker and the employer client will be jointly and severally liable.

1.1 Regulation of working time

The following provisions apply to all employees, except those who are senior managers, sales staff who travel to the premises of customers and regulate their own hours of work, and employees who work fewer than 24 hours a month for an employer.

- **Maximum ordinary hours a day**: An employer may not allow an employee to work more than 45 ordinary hours in any week. Similarly, an employee may not work more than nine ordinary hours in any day if he or she works a five-day week, or eight ordinary hours in any day if he or she works more than five days a week.
- **Overtime**: Currently, there is a maximum number of three hours of overtime allowed each day, subject to a maximum of ten hours of overtime each week. By collective agreement, an employee may work up to a maximum of 15 hours' overtime a week. A small-business employer who employs fewer than ten employees may also require employees to work up to 15 hours' overtime a week.[2]

  Minimum payment for overtime is one and one-half times the normal wage. By agreement, the employee can be paid either the normal wage plus 30 minutes' paid time off for every hour of overtime worked,

or the employee can be granted 90 minutes' paid time off for each hour of overtime worked.

Any agreement about overtime that is entered into by the employer with the employee during the first three months of employment will lapse after one year.

- **Compressed working week**: A written agreement can provide that the employee works up to 12 hours each day, provided that the maximum number of hours each week is not exceeded.
- **Meal intervals**: After five continuous hours worked, the employee must be granted a one-hour meal interval, which is unpaid unless the employee is required to be in attendance to perform duties. A written agreement may reduce the meal interval to 30 minutes, or do away with it, if the employee works for fewer than six hours on a particular day.
- **Daily and weekly rest period**: The employee must be allowed a daily rest period of at least 12 consecutive hours before recommencing work. By written agreement, this can be reduced to ten hours if the employee lives on the premises and the meal interval lasts for at least three hours. The employee must also be allowed a weekly rest period of at least 36 consecutive hours that must include a Sunday, unless otherwise agreed.
- **Sunday pay**: The employee must receive double pay, unless he or she normally works on a Sunday. In that case, he or she must be paid at one and one-half times the normal pay.
- **Night work**: This means work regularly performed after 18:00 and before 06:00 the next day. An employer may only allow an employee to perform night work if either the employee is paid an allowance or working hours are reduced. Transport must be available between the employee's place of residence and the workplace at both the commencement and the conclusion of the shift. The employer must inform the employee of any health and safety hazards associated with the work, and pay for the employee to undergo a medical examination at reasonable intervals.
- **Public holidays**: These days are paid time off and may only be worked by agreement. If worked, the employee must be paid at least double the normal wage. In terms of the Public Holidays Act,[3] a public holiday is exchangeable by agreement for another day.

It is a criminal offence to breach any of the above provisions. A court may sentence a person found guilty to a fine of a minimum of R10 000 or to imprisonment of a minimum of 12 months.

Difficulty may be experienced defining ‘senior managerial employee’. However, regulations published in the *Government Gazette* provide that any employee earning more than R172 000 each year is excluded from the provisions of the Act relating to the regulation of working time. This amount is known as the ‘threshold’.

An employee earning more than the threshold each year therefore has no statutory limitations imposed on maximum normal working hours, overtime, paid time for Sundays or public holidays, rest periods, meal intervals, or night work. For the purposes of the threshold, ‘earnings’ means gross pay before deductions (income tax, pension, medical and similar payments but excluding contributions made by the employer in respect of the employee).[4]

***Mondi Packaging (Pty) Ltd v Director-General: Labour and others*[5]**

Two employees did not normally work overtime but they did so from time to time. The employer argued that when including the overtime amount they earned the previous year, their earnings exceeded the threshold and they were therefore not eligible for the payment of double time on a Sunday. In other words, because they earned above the threshold they were excluded from the Sunday work provisions contained in the BCEA.

The employees' calculation of their earnings excluded the overtime pay they had received the previous year, and they argued that because their earnings fell within the threshold their employer was required to pay them double time on a Sunday, as per the BCEA.

The Labour Appeal Court held that overtime pay is not included in an employee's ‘gross pay’ for purposes of the threshold. To include overtime pay in an employee's gross pay in such circumstances would bring about uncertainty. Where an employee is only required to work overtime on occasion, neither the employer nor the employee would know in advance how much overtime the employee would work in any given year.

1.2 Leave

Provisions relating to leave do not apply to a person who works fewer than 24 hours a month for an employer.

- **Annual leave**: Annual leave of 21 consecutive days must be granted on full remuneration for each completed year of service. Annual leave must be granted within six months of the end of each anniversary of

employment. Annual leave may not be taken during any other period of leave or during a period of notice of termination of employment. The employer cannot require the employee to take only a part of his or her leave. Annual leave may not be cashed out, except on termination of employment.

- **Sick leave**: A sick leave cycle means 36 months' continuous employment. The employee is entitled to the same number of days on paid sick leave during a sick leave cycle as he or she would work during any six-week period. Generally, an employee accrues one day of paid sick leave for each completed month worked.
- **Proof of incapacity**: Sick leave does not have to be paid if the employee fails to produce a medical certificate after an absence of more than two consecutive days, or if he or she has been absent on more than two occasions during an eight-week period.
- **Maternity leave**: The employee is entitled to four consecutive months' maternity leave. She does not have to be paid by the employer for this leave. However, she is able to claim payment of maternity benefits in terms of the Unemployment Insurance Act.[6]
- **Family responsibility leave**: An employee who works more than four days a week, and who has been employed for longer than four months, may take three days' paid leave during each annual leave cycle to attend to the birth or illness of his or her child, or death of his or her spouse or life partner, parent, grandparent, child, grandchild, or sibling. Proof may be required. The unused entitlement lapses at the end of each annual leave cycle.

  A small-business employer who employs fewer than ten employees may also reduce the annual leave entitlement of employees by the number of days of family responsibility leave granted to the employee on full remuneration.[7]

It is a criminal offence to breach any of the above provisions. The court may sentence a person found guilty to a fine of a minimum of R10 000 or to imprisonment of a minimum of 12 months.

1.3 Particulars of employment and remuneration

The following administrative requirements do not apply to a person who works fewer than 24 hours a month for an employer.

- **Written particulars of employment**: The employee must be given the following in writing: full name and address of the employer; name and occupation of the employee or a brief description of the work to be done; place or places of work; date of commencement; ordinary hours and days of work; wage and method of calculating wages; rate of pay for overtime work; cash payments; payments in kind; frequency of remuneration; deductions to be made; leave to which the employee is entitled; period of notice required for termination, or date of termination if employment is for a specified period; and a list of documents forming part of the contract of employment.
- **Informed of rights**: A summary of rights under the Act must be displayed at the workplace in the official languages spoken at that workplace.
- **Keeping records**: Records must be kept for three years after termination of employment: employee's name and occupation; time worked; and remuneration paid.
- **Payment of remuneration**: Provisions in contracts of employment agreeing to amounts that are less than those provided by statute, or to waivers of benefits provided by statute, are void.

  Payment must be made by cash or cheque in a sealed envelope, or may be made by direct deposit into a bank account nominated by the employee. Payment must be made within seven days of the period for which remuneration is payable, or after termination of employment.

  An employee on a fixed-term contract must be given benefits that are the same, or of the same value, as benefits given to a permanent employee.

  An employer is not allowed to require an employee or job applicant to pay money, or provide the employer with any benefit, either to get a job or to be given particular work once employed.
- **Information about remuneration**: Written details must include the name of employer and address; the employee's name and occupation; period for which payment is made; amount and purpose of any deduction; actual amount paid to employee; if relevant, the rate of remuneration and overtime rate, number of ordinary and overtime hours, and the number of Sunday and public holiday hours.

- **Deductions**: These are not allowed unless agreed to specifically in writing, or are required in terms of a collective agreement, law, or court order. A deduction that is agreed to in writing can only be for the purposes of reimbursing an employer for loss or damage that happened in the course of employment and was the fault of the employee. A fair procedure must be followed to provide the employee an opportunity to state why the deduction should not be made. The total deductions must not exceed one-quarter of the employee's remuneration for that period.
- **Calculation of remuneration and wages**: The wage is simply what the employee earns as a basic salary or wage for the period. Remuneration is calculated as being the wage plus allowances and bonuses. Remuneration does not include amounts payable to an employee to enable him or her to work, such as reimbursable travel costs. If remuneration fluctuates (for example, when commissions are paid), then the remuneration is averaged over the previous 13 weeks.

Items included in the definition of remuneration for the purposes of calculating pay for annual leave, notice pay, and severance benefits are the following:

- Housing or accommodation allowance or subsidy, or housing or accommodation received as a benefit in kind.
- Car allowance or provision of a car, except to the extent that the car is provided to enable the employee to work.
- Any cash payments made to an employee, or any other payments made in kind to an employee, except those listed as exclusions.
- Employer's contributions to medical aid, pension, provident fund or similar scheme.
- Employer's contributions to funeral or death benefit schemes.

The following items are excluded from the definition of remuneration:

- Any cash payment or payment in kind provided to enable the employee to work. For example, an equipment, tool or similar allowance or the provision of transport or the payment of a transport allowance to enable the employee to travel to and from work.
- Relocation allowance.

- Gratuities. For example, tips from customers, and gifts from the employer, such as a gold watch or farewell gift on termination of employment.
- Share incentive schemes.
- Discretionary payments not related to an employee's hours of work or work performance. For example, a profit-sharing scheme.
- Entertainment allowance.
- Education or schooling allowance.

It is a criminal offence to breach any of the above provisions. A court may sentence a person found guilty to a fine of a minimum of R10 000 or to imprisonment of a minimum of 12 months.

1.4 Termination of employment

Provisions relating to the termination of employment do not apply to a person who works fewer than 24 hours a month for an employer.

- **Notice of termination of employment**: If the employee has been employed for fewer than six months, notice of one week must be given. Two weeks' notice must be given if the employee has been employed for less than one year. Four weeks' notice must be given if the employee has been employed for more than one year, or if he or she is a farm worker or domestic worker who has worked for more than four weeks.

  Notice of termination may not be given during any period of leave to which the employee is entitled, nor may notice of termination run simultaneously with any period of leave.
- **Payment instead of notice**: Instead of allowing an employee to work, the employer may pay the employee the remuneration he or she would have received. This is known as ‘payment in lieu of notice’. If the employee resides in accommodation provided by the employer, he or she may stay there for the duration of the normal notice period.
- **Severance pay**: If an employee is dismissed for operational requirements (retrenched), the employee is entitled to receive payment of one week's remuneration for each completed year of continuous service with that employer. If the employee unreasonably refuses an offer of alternative employment with that employer, or with another employer, he or she forfeits the right to severance pay.[8] This provides an

incentive for employers who arrange alternative employment for employees who would otherwise be retrenched. If employees could refuse alternative employment and still get their severance pay, then there would be no incentive for the employer to attempt to secure a job for them.

It is a criminal offence not to pay notice pay or severance pay when required. A court may sentence a person found guilty to a fine of a minimum of R10 000 or to imprisonment of a minimum of 12 months.

- **Certificate of service**: On termination of employment, the employee is entitled to a certificate of service stating his or her full name; the name and address of the employer; dates of commencement and termination of service; title of job or brief job description; remuneration as of date of termination; and, if the employee requests, the reasons for termination of employment.

1.5 Prohibition of employment of children and forced labour

'Forced labour' means that someone will be punished if they do not provide work. The Act prohibits forced labour. Also, no person may employ a child under the age of 15 years. A person found guilty of forced labour or of the employment of a child may be sentenced to a minimum of six years imprisonment.

1.6 Variation of basic conditions of employment

The Act describes how certain individual or collective agreements may vary some of the provisions of the Act. Generally, a valid agreement with an individual employee can be contained in a contract of employment, but will lapse one year after it is signed. A collective agreement generally will endure indefinitely.

1.7 Monitoring, enforcement, and legal proceedings

Labour inspectors monitor and enforce compliance with employment laws by advising parties of their rights and obligations, conducting inspections, investigating complaints, and obtaining undertakings or issuing compliance orders.

A labour inspector may at any reasonable time enter any workplace without a warrant or notice. He or she may enter a home only with the consent of the owner, or if authorised to do so by the Labour Court. He or she may require a person to disclose information on any employment matter, question a person about any employment record, and copy or remove any employment record or document, or require a person to deliver any employment record or document to a place for inspection.

A labour inspector may inspect and question a person about, and if necessary remove, any article, substance, or machinery, and may inspect or question a person about any work performed.

It is a criminal offence to refuse entry to a labour inspector or to refuse to comply with requests made by a labour inspector under the Act. A court may sentence a person found guilty to a fine of a minimum of R10 000 or to imprisonment of a minimum of 12 months.

Where a labour inspector has reasonable grounds for believing that an employer has not complied with the law, the inspector must try to get a written undertaking from the employer that he or she will comply.

The inspector may issue a compliance order, which will state the provision of the Act with which the employer has not complied, the amount that the employer must pay the employee, details of any failure by the employer to comply with a written undertaking, and details of the steps to be taken by the employer to comply and the period within which the steps must be taken. The employer must display the compliance order prominently at a place accessible to the affected employees in the relevant workplace or workplaces.

An employer can object to the compliance order by making written representations to the Director-General of the Department of Labour, who may modify or cancel the order, or require the employer to comply with it within a specified period of time. An employer may appeal to the Labour Court against an order of the Director-General. If an order of the Labour

Court is not complied with, the court may impose a fine depending on how many previous times the employer has failed to comply with a Labour Court order.

For a matter involving an underpayment, where the employer has failed on four occasions within three years to comply with a Labour Court order in respect of the same provision of the Act, the maximum fine that can be imposed is of 200 per cent of the amount due, including any interest owing on the amount at the date of the order.

For a matter not involving an underpayment, where the employer has failed on four occasions within three years to comply with a Labour Court order in respect of the same provision of the Act, a maximum fine can be imposed of R500 for each employee in respect of whom the failure to comply occurs.

2 Occupational Health and Safety Act[9]

This Act provides for the health and safety of persons at work and in connection with the use of plant and machinery; protection against hazards to health and safety arising from activities of people at work; and the establishment of an advisory council for occupational health and safety.

The Act excludes premises controlled in terms of both the Mines and Works Act[10] and the Explosives Act,[11] since these Acts contain their own safety regulations.

In terms of the Act every employer must provide and maintain a safe working environment. The employer must provide and maintain all the equipment necessary to do the work, and all the systems according to which the work is to be done, in a condition that does not adversely affect the health and safety of employees.

Before using personal protective equipment, the employer must try and reduce or remove the danger. Only after this should personal protective equipment be utilised. The employer must take measures to protect workers' health and safety against hazards that may result from the production, processing, use, handling, storage or transport of articles or substances.

To ensure that these obligations are met, the employer must:

- Identify potential hazards that may be present while work is done, or something is produced, processed, used, stored or transported, and any equipment is being used.
- Establish the precautionary measures that are necessary to protect workers against the hazards and provide the means to implement these precautionary measures.
- Provide the necessary information, instruction, and appropriate training and supervision to ensure the health and safety of employees.
- Not allow anyone to do any task unless the relevant precautionary measures have been taken.
- Take all necessary steps to ensure that the Act is complied with, and enforced.

The employer also has a duty to ensure that every employee is informed about the hazards to his or her health, the safety attached to any work that must be performed, and the precautionary measures that must apply in respect of the hazards.

Every employee must:

- Take reasonable steps to ensure his or her own safety and that of others who may be affected by any act or omission.
- Cooperate with the employer to enable the employer to meet its obligations in terms of the Act.
- Carry out any lawful order and obey safety rules given to him or her.
- Report any unsafe or unhealthy situation to the employer or the health and safety representative for the workplace.
- Report any incident involving health and safety by no later than the end of the same shift, or as soon as practicable thereafter.

In terms of the Act, a manufacturer is obliged to provide an instruction manual or operating procedure or a safe-working procedure with equipment.

If an employee contravenes the Act, it is presumed that the employer contravened the Act, unless the employer can prove that the employee was acting without permission; outside his or her authority; and the employer took all reasonable steps to prevent the employee from contravening the Act.

The Act places sole responsibility and liability on the chief executive officer (CEO) to ensure that the company complies with the Act. If the company has a board of directors, the person with the highest authority will be regarded as the chief executive officer for the purposes of the Act. The CEO may assign any duty to immediate subordinates. However, he or she will remain liable and must ensure that all reasonable steps have been taken to ensure the correct implementation of the Act and the regulations.

Extensive regulations have been promulgated in terms of the Act, all of which are legally binding.[12]

3 Unemployment Insurance Act[13]

The Act provides for the establishment and administration of a central fund, financed through compulsory contributions by employers, employees, and the State.

In terms of the Act, the amount of the contribution payable by an employer is a total of two per cent of the employee's remuneration. The employer deducts one per cent from the remuneration paid to an employee, and contributes the other one per cent.

The following employers and employees are excluded from the Act, do not have to make any contribution, and, in the case of employees, will not receive any unemployment benefit:

- Employees employed for fewer than 24 hours a month with a single employer.
- Employees who are entitled to remuneration in terms of a learnership agreement registered in accordance with the Skills Development Act.[14]
- Employees in the national and provincial spheres of government.
- Migrant employees who enter South Africa subject to an undertaking with their government to repatriate them on completion of their contract of fixed-term contract, apprenticeship or learnership.
- Employees receiving a monthly pension from the State, or a benefit from the Compensation Fund established by the Compensation for Occupational Injuries and Diseases Act.[15]

3.1 Classes of benefits

Subject to the Act, contributors are entitled to the following classes of benefits:

- **Unemployment benefits**: The benefit is payable provided that the person has been unemployed for more than 14 days, and employment was terminated by the employer or by expiry of a fixed-term contract of employment. Resignation by the employee does not qualify him or her for a benefit. A domestic worker is entitled to claim unemployment

benefits for a period lasting more than 14 days if the reason for termination of employment was the death of the employer. The contributor must also register with an employment office established under the Skills Development Act,[16] and must be capable of, and available to, work. An unemployed contributor will not be entitled to claim unemployment benefits if he or she fails to report at the times, dates, and places stipulated by the claims officer or refuses, without good reason, to undergo training and vocational counselling.

- **Illness benefits**: The contributor will not be entitled to claim benefits, in the following cases: if he or she still has due to him or her a portion of paid sick leave entitlement in terms of the Basic Conditions of Employment Act;[17] if the period of illness is fewer than 14 days; if for any period he or she is able to claim unemployment benefits; or if he or she refuses or fails to carry out the instructions of his or her medical practitioner, without good reason.
- **Maternity benefits**: The benefit is payable only if the contributor is paid 50 per cent or less of her normal remuneration during maternity leave provided by the employer. The benefit payable may be adjusted to take into account any amount the contributor receives from the employer. The duration of payment of the benefit is limited to a maximum of 17 weeks.

  A contributor who has a miscarriage during the third trimester or bears a stillborn child is entitled to a maximum maternity benefit of six weeks payable from the date of the miscarriage or stillbirth.
- **Adoption benefits**: The benefit is payable only if the contributor is paid 50 per cent or less of his or her normal remuneration during any leave provided by the employer. No benefit can be claimed for the period the employee uses his or her paid leave entitlement. Benefits will be paid only if the child is under two years of age. The benefit payable may be adjusted to take into account any amount the contributor receives from the employer.
- **Dependant's benefits**: A surviving spouse of a contributor who dies in employment may be entitled to claim benefits. If there is no application for benefits within six months of the death, or if there is no surviving spouse, then a child of the deceased will be entitled to claim benefits. The benefit is only payable if the monies received by the dependant,

from whatever source as a result of the dependant's death, are less than 50 per cent of the usual remuneration of the contributor. The benefit payable may be adjusted to take into account any amount the dependant receives from the employer.

Benefits are not subject to taxation in terms of the Income Tax Act.[18]

3.2 Scale of benefits

A contributor is eligible to receive one day's benefit for every six completed days of employment, up to a maximum of 238 days (34 weeks). A contributor will therefore be eligible to claim benefits for the maximum duration after being continuously employed for four years. If a contributor has already drawn benefits (other than maternity benefits) in the preceding four years, the number of days for which the contributor is eligible to claim benefits will be reduced accordingly.

A contributor is not entitled to receive benefits for any period he or she is outside the country, or in receipt of any of the following:

- Monthly pension or disability grant from the State.
- Benefit from the Compensation Fund in terms of the Compensation for Occupational Injuries and Diseases Act,[19] as a result of an occupational injury or disease.
- Benefit from any unemployment fund or scheme established by a council in terms of the Labour Relations Act.[20]
- The duration of the period that the contributor is in receipt of any retrenchment, gratuity, or severance pay from his or her former employer. Once this is exhausted, however, he or she is entitled to claim benefits.

The scale of benefits is on a sliding scale and payment varies from a maximum of 60 per cent to a minimum of 38 per cent, according to remuneration. Low-income contributors may receive up to 60 per cent of their remuneration, whereas high-income contributors may receive a maximum of 38 per cent, capped at an earnings threshold. As at 1 February 2008, if a contributor earns more than a threshold of R12 478 a month, or R149 736 a year, then benefits will be paid at the level of the threshold. For example, if someone earns R15 000 a month, then the maximum benefit he

or she is able to claim is the same as that of someone who earns R12 478 a month. The level of this threshold may be amended from time to time.[21]

Application for benefits must be made on the prescribed form and submitted within six months of termination of employment.

A contributor who wishes to dispute a decision of the Commissioner suspending his or her right to benefits, or a decision of a claims officer relating to payment or non-payment, may refer the dispute for resolution to the Commission for Conciliation, Mediation and Arbitration (CCMA).

The Labour Court and Labour Appeal Court have jurisdiction in respect of all matters regarding the Act, with the exception of any offences.

3.3 Enforcement

Where an inspector has reasonable grounds for believing that an employer has not complied with the law, the inspector must try to obtain a written undertaking from the employer that he or she will comply.

The inspector may issue a compliance order. An employer can object to the compliance order by making written representations to the Director-General of the Department of Labour, who may modify or cancel the order, or require the employer to comply with it within a specified period of time.

The Director-General may apply to the Labour Court to have the compliance order made an order of the Labour Court.

3.4 Offences

The following are offences and make the offender liable on conviction to imprisonment for up to two years:

- Knowingly make a statement that is materially false or that results in an incorrect payment of a benefit.
- Wilfully make any false entry on a contributor's record card or document relating to employment history or a claim for benefits.
- Contravene, refuse, or fail to comply fully with the provisions of the Act or any regulation or notice issued in terms of the Act.

Any person who causes any loss or damage to the Fund is guilty of an offence. A court may determine the amount of loss or damage, and require that person to refund the loss.

Loss or damage to the Fund includes any of the following:

- An employer's irregular payment or failure to pay monies due.
- A contributor's failure to inform the claims officer of the resumption of work during the period in respect of which benefits were being paid.
- Payment of monies from the Fund as a result of a false statement or fraudulent claim.
- Any failure to comply with any duty imposed by the Act leading to any loss or damage to the Fund.

In any proceedings concerning a contravention of the Act, the onus is on the employer to prove that its records are valid and accurate.

4 Unemployment Insurance Contributions Act[22]

The Act creates a duty on every employer and every employee to whom it applies to contribute to the Unemployment Insurance Fund on a monthly basis. With some exceptions, virtually all employees are required to become contributors and may be eligible to claim unemployment benefits. Importantly, certain independent contractors and their employers also may be required to become contributors, provided that the contractors are deemed for the purposes of the Fourth Schedule to the Income Tax Act[23] to be employees. This will happen if they spend more than 75 per cent of their working time doing work for a single employer, if they receive more than 75 per cent of their income from a single employer, or if, in terms of the dominant impression test, they are deemed to be employees.

An employee must pay one per cent of the remuneration during any month, and the employer must also pay an amount equal to one per cent of the remuneration payable to that employee during any month. If the employee is a high earner, then the respective contributions must only be made up to a threshold to be determined from time to time by the Minister of Finance. As at 1 February 2008, the threshold was R12 478 a month, or R149 736 a year.

The employer must deduct the employee's contribution from the remuneration payable to that employee during that month. Failure by the employer to make the deduction renders the employer liable for the payment of the amount.

The employer must pay the amounts over to the Unemployment Insurance Commissioner on a monthly basis. Late payments attract interest. Before the seventh day of each month the employer must notify the Commissioner of any terminations of employment, or appointments of new employees.

Where an employer fails to perform any duty imposed by the Act or does anything with intent to evade the payment of any amount of contribution or to cause a refund to that employer, an additional penalty

may be imposed of up to an amount equal to double the amount of the contribution or the refund.

5 Skills Development Act

The Skills Development Act[24] aims to increase levels of investment in education and training in the labour market. Employers are meant to provide employees with new opportunities to acquire skills, to assist new entrants to the labour market to gain work experience, and to employ people who find it difficult to be employed. Employees are meant to participate in learnership and other training programmes.

The Act seeks to do all this by the creation of:

- **The National Skills Authority**: This structure advises the Minister of Labour on national skills development. The Minister appoints representatives of business, labour, and the community as nominated by the National Economic Development and Labour Council (NEDLAC). Community representatives must include persons representative of women, youth, and the disabled. In addition, the Minister must appoint persons representing the interests of the State, education and training providers, and experts in providing employment services.
- **Sectoral education and training authorities (SETAs)**: These authorities, which may be established for any particular national economic sector, develop a skills plan, and establish and promote learnerships, register learnership agreements, approve workplace skills plans, collect skills development levies, allocate grants, and monitor education and training in the sector.
- **The National Skills Fund**: Twenty per cent of the funds collected in terms of the Skills Development Levies Act[25] must be given to the National Skills Fund. Money must be used for projects identified in the national skills development strategy.
- **Labour centres**: The Department of Labour establishes labour centres to register work-seekers and employment service providers, register vacancies and work opportunities, and provide employment services for workers, employers, and training providers.
- **The Skills Development Planning Unit**: Its purpose is to research and analyse the labour market in South Africa, and to assist in the formulation of national and sectoral policy. It must also provide

information to the Minister, the National Skills Authority, SETAs, and education and training providers.

The provision of any false information, any attempt to obtain a prescribed document by false pretences, or any obstruction of a person acting in terms of the Act is a criminal offence. Infringement carries a maximum penalty of one year's imprisonment.

6 Skills Development Levies Act[26]

In terms of this Act, every employer must pay a skills development levy at a rate of one per cent of the ‘leviable amount’. The leviable amount means the total amount of remuneration due by an employer to its employees during any month. This does not include any amount payable to an independent contractor or a labour broker; or payable to any person by way of any pension, superannuation allowance, or retiring allowance.

The levy is not payable by a public service employer in the national or provincial sphere of government, any religious or charitable institution, or a national or provincial public entity.

An employer must pay the levy not later than seven days after the end of each month. The Director-General of the Department of Labour allocates 20 per cent of the levies, interest, and penalties collected in respect of a SETA to the National Skills Fund, and 80 per cent of the levies, interest, and penalties collected in respect of a SETA to that SETA.

Interest is payable on any outstanding amount. A penalty of ten per cent of the unpaid amount may also be payable, in addition to the interest.

A labour inspector appointed in terms of the Basic Conditions of Employment Act[27] is regarded to be an inspector regarding the collection of levies.

Failure to apply for registration for purposes of the levy, or failure to pay the levy, are offences that make the offender liable on conviction for a fine, or imprisonment for up to one year.

7 Compensation for Occupational Injuries and Diseases Act[28]

Under the common law, an employee injured at work was at a disadvantage, and had to show that the person from whom he or she claimed compensation was vicariously negligent. Problems included lack of proof, lack of funds, and the fear of suing one's own employer. If the injury was partly the employee's own fault, he or she was without remedy. Also, by knowing and appreciating the risks involved in dangerous work, he or she was taken to have consented to the injury by continuing with the work.[29]

The Act modifies the common-law position by providing compensation for disablement caused by occupational injuries or diseases sustained or contracted by employees during the course of employment.

Urquhart v Compensation Commissioner [30]

A press photographer suffered a breakdown as a result of having witnessed numerous stress-inducing events over many years. He was diagnosed with post-traumatic stress disorder and he was unable to continue working. His claim for compensation in terms of the Act was rejected on the basis that it was not shown that his medical condition was the result of an 'accident' arising in the course of his employment, and post-traumatic stress disorder was not an occupational disease within the meaning of the Act.

On appeal the court held that there was no evidence that post-traumatic stress disorder cannot amount to an occupational disease. The terms 'accident' and 'occupational injury' are broad classifications to make provision for different kinds of compensation for different kinds of disorders. The important factor was that the accident or injury arose out of and in the course of the employee's employment and resulted in the personal injury, illness or death of the employee.

When death results from these injuries or diseases, payment is made to the dependants of the employee concerned. Payouts are calculated on a scale, according to particular maximum earnings per year, in the event of temporary or permanent disability, or serious disfigurement arising from injuries suffered or diseases contracted in the course of employment. When totally disabled and prevented from working, the employee receives periodic payments for the duration of the incapacity, not exceeding a percentage of the former monthly earnings.

Table 24.1 *Compensation in each category of disablement* [31]

	Compensation for categories of disablement
Temporary total disablement	75% of monthly earnings at the time of the incident, subject to a maximum of R6 064.50 per month. Temporary disablement for more than 24 months is deemed permanent. Employers must pay compensation for the first three months from the date of the accident; however, this will be refunded by the Commissioner after three months.
Temporary partial disablement	The Commissioner will determine the payment based on a portion of the amount calculated for temporary permanent disablement.
30% permanent disablement or more	Lump sum of 15 times the employee's monthly earnings, subject to a total amount of between R12 375 and R67 950.
Less than 30% permanent disablement	Lump sum comprising the proportionate percentage of the 30% permanent disablement amount. The Act sets out the types of injuries that qualify as permanent disablement, as well as the extent to which they constitute permanent disablement.
100% disablement	Monthly pension for life of 75% of an employee's monthly earnings at the time of disablement, subject to a minimum of R618.75 and a maximum of R6 064.50.
31%–99% disablement	Monthly pension for life comprising the proportionate percentage of the 100% disablement amount.

Dependants receive payments until they become self-supporting. Lump sum awards are made when an employee suffers a permanent partial disablement impairing his or her ability to earn by 30 per cent or less, or when he or she loses the use of a limb, eyesight, hearing, or sensory perception.

Table 24.2 *Compensation payable to dependents until they become self-supporting*[32]

	Compensation payable to different categories of dependants
Widow/widower and no child	A lump sum of twice the employee's monthly pension that would have been payable had he or she been totally permanently disabled.
Widow/widower with child	A monthly pension of 40% of the monthly pension that would have been payable to the employee had he or she been totally permanently disabled.
Child	A monthly pension of 20% of the monthly pension that would have been payable to the employee had he or she been totally permanently disabled.

The Compensation Fund from which payments are made is maintained by compulsory levies on employers. Employers are assessed annually on the basis of their total payrolls and the accident risk attached to their operations.

Basic statutory compensation is payable regardless of fault on the part of the employee or any other person. An employee whose own negligence contributed to the injury may only claim basic statutory compensation. Where the employee is injured through the actions of someone other than the employer, he or she is entitled to claim basic statutory compensation from the Fund, as well as the balance of his or her damages from the negligent third person.[33]

An employee who is injured off duty may not claim from the Fund, but is left with their common- law remedies.

8 Labour Relations Act[34]

8.1 Purpose, application, and interpretation of the Act

This Act covers all employers and employees, excluding those employed by the National Defence Force, the National Intelligence Agency, and the South African Secret Service. A labour broker (temporary service provider) is jointly and severally liable with the employer client for breaking any collective agreement or arbitration award.

The primary objects of the Act are to promote economic development, social justice, and peaceful labour relations by promoting orderly collective bargaining and employee participation in decision-making in the workplace, promoting the effective reolution of disputes, and giving effect to South Africa's obligations as a member of the International Labour Organisation. It also gives effect to the rights contained in section 27 of the Constitution,[35] which states that every person shall have the right to fair labour practices; workers and employers shall have the right to organise and bargain collectively; workers have the right to strike for the purpose of collective bargaining and employers have recourse to lock-out for collective bargaining.

8.2 Freedom of association and general protections

Every employee has the right to form, join, and participate in lawful trade union activities. The right of freedom of association is extended to all employees and persons seeking employment. All forms of victimisation are prohibited. Contracts infringing on the rights of trade unions to draw up their own rules and constitutions are void.

Disputes will first be subject to conciliation by a bargaining council or the Commission for Conciliation, Mediation and Arbitration (CCMA), before being referred to the Labour Court.

8.3 Organisational rights

Sufficiently representative trade unions have legal rights to:

- Access to the employer's premises for recruitment, communication, and trade union purposes. Rights of access do not apply to domestic servants.
- Hold meetings on the employer's premises outside of working hours.
- Conduct a ballot on the employer's premises.
- Obtain information for collective bargaining purposes.
- Receive deductions for trade union subscriptions or levies.

A collective agreement may detail the extent of trade union membership necessary for the union to be regarded as representative. In the absence of such an agreement, a sufficiently representative trade union is generally one with at least 30 per cent membership of the bargaining unit at the workplace.

Trade union representatives may be elected from workers at the workplace. As a guide, there will be one representative if there are ten members at the workplace; two if there are 20 members, and if there are over 50 members, there will be two representatives for the first 50 members, and one additional representative for each additional 50 members, subject to a maximum of seven representatives. If there are more than 600 members at the workplace, a maximum of 12 representatives may be elected. If there are more than 1 000 members, a maximum of 20 trade union representatives may be elected.

Trade union representatives have a right to reasonable time off with pay during working hours to perform the functions of a trade union representative and to be trained in any subject relevant to that performance.

The employer has a duty to disclose sufficient relevant information to the representatives to allow them to perform their trade union duties effectively, consult, and bargain collectively. Disputes must be referred to the CCMA for conciliation, and, if unresolved, then to arbitration. The CCMA will examine the harm disclosure of the information may have on the ability of the trade union representative to perform his or her function effectively. The CCMA may decide that disclosure should be made in a way that limits the harm to the employer. The rights of disclosure of information do not apply to domestic servants.

8.4 Centralised bargaining [36]

The Act promotes centralised bargaining by providing for three options:

8.4.1 Collective agreements

A collective agreement binds the parties entering into it. It also will bind non-members of a trade union party to the agreement if:

- The employees are identified in the agreement.
- The agreement expressly binds the employees.
- The trade union has a majority of employees in the workplace as its members.

Any dispute about the interpretation or application of a collective agreement is referred to the CCMA for conciliation and, if unresolved, then to arbitration.

8.4.1.1 Agency shop arrangements[37]

A representative trade union and an employer may enter into a collective agreement called an agency shop agreement requiring the employer to deduct an agreed agency fee from wages of employees who are identified in the agreement and who are not members of the trade union. An agency shop is a system that requires non-union employees to pay an amount into a special fund kept by the union. The amount may not be more than a union member's subscription. This money may only be used to advance and protect the socio-economic interests of employees.

The aim of an agency shop is to ensure that non-union employees, who nevertheless benefit from the union's bargaining efforts, make a contribution towards those efforts.

8.4.1.2 Closed shop agreement[38]

A representative trade union and an employer may enter into a collective agreement, called a closed shop agreement, requiring all employees to be members of the trade union. A ballot must be held and two-thirds of the employees to be covered by the agreement must vote in favour of it. No money deducted in this manner may be paid to any political party. No trade union may refuse membership to any person, unless the refusal is in accordance with the trade union's constitution, or the reason for the refusal is fair.

If there is a closed shop agreement in place, the employer may dismiss an employee who refuses to become a member of the trade union, or whose membership is terminated, provided his or her refusal is not based on the grounds of conscientious objection. If a union expels a member or refuses to allow a new employee to become a union member and if this expulsion or refusal is in accordance with the union's constitution or is for a fair reason, then the employer will have to dismiss the employee.

A ballot may be called to terminate a closed shop agreement if one-third of all employees covered by the agreement sign a petition, and three years have passed since the agreement commenced or the last ballot was held.

8.4.2 Bargaining councils[39]

Bargaining councils may negotiate agreements on a range of issues, including wages and conditions of work, benefits, training schemes, and disciplinary and grievance procedures.

The primary functions of a bargaining council are to promote industrial peace by concluding and enforcing collective agreements; preventing and resolving disputes; and provision of an advisory service to members. A bargaining council may also establish and administer pension, provident, medical aid, sick pay, holiday, unemployment, and training schemes.

Bargaining councils must be registered and have constitutions. No trade union or employer's organisation is obliged to be a party to a bargaining council; participation is voluntary. However, at the request of the bargaining council, the Minister may extend a bargaining council collective agreement to everyone in the industry, even if they are not parties to the bargaining council. Failure to comply with a bargaining council agreement is a criminal offence.

Bargaining council agreements typically include minimum wages per job grade and wage increases; hours of work; annual leave; sick pay and provision for sick pay; public holidays; overtime hours and related payments; benefit funds; retrenchment procedures and packages; maternity benefits; procedures for the resolution of unfair labour practices and other disputes; and provision for the establishment of a closed shop.

The advantages of the bargaining council system are that common conditions are set for an entire industry. Employers are forced to comply

with agreements that are policed by inspectors, non-compliance is a criminal offence and non-unionised workers are protected. Unions benefit by not having to negotiate separately with every individual employer and small employers are relieved of the problems of collective bargaining and arranging benefit schemes for their employees.

8.4.3 Statutory councils

Where no bargaining council exists or is established, a party whose members constitute at least 30 per cent of the employees in a sector and area may apply for the establishment of a statutory council.

While the parties to a statutory council can draw up agreements on wages and working conditions, these agreements cannot be extended to employers and employees outside the council. However, agreements on training schemes, provident or pension funds, medical schemes and similar benefit schemes can be extended by the minister to cover all employers and employees in that sector.

Unions that are members of a statutory council will enjoy the advantage of acquiring organisational rights of access, meetings, ballots and stop-order facilities for all workplaces in that sector. The rights will apply even in a workplace in that sector where the union has no members.

8.5 Industrial action[40]

This typically takes the form of a strike or a lock-out.

8.5.1 Strikes[41]

A strike must involve two or more employees. For example, a single domestic worker in a household cannot strike. Striking employees may work for the same or different employers. Striking employees must act with a common work-related purpose. For example, industrial action over the removal of a politician is not a strike.

The action can be a partial or complete refusal to work or the retardation or obstruction of work. For example, go-slows, work-to-rule, intermittent strikes (where employees stop and start the same strike over a period of

time) and overtime bans. An overtime ban initiated by employees concerning voluntary or compulsory overtime constitutes a strike.

The reason must be to solve a grievance or dispute about a matter of mutual interest that concerns employees and employers. For example, a dispute between two unions does not constitute a strike nor does a non-work-related grievance.

The Act provides that every employee has the right to strike and every employer the right to lock-out, provided the dispute was referred to a council or the CCMA, has remained unresolved for 30 days, and 48 hours' written notice to the other side has been given.[42] These procedures do not apply where the parties are bound by a collective agreement detailing alternative procedures, or the action is in response to unprocedural industrial action from the other side.

A strike or lock-out in terms of the Act is not a breach of contract and participants are indemnified from civil liability. Strikers engaging in a protected legal strike may not be dismissed for participation. However, they may be validly dismissed for their conduct during the strike, or for a reason based on the employer's operational requirements. The failure by a trade union or employer to comply with a provision in its constitution regarding any ballot shall not affect the legal protection offered to a legal strike or lock-out.

A secondary strike is a strike in support of a strike by other employees against their employer. Secondary strikes are legal if the employees have complied with the provisions of the Act and have given the employer seven days' written notice prior to the commencement of the strike. A secondary strike should have a possible effect on the business of the primary employer. The nature and extent of the secondary strike should also be reasonable in relation to the possible effect on the business of the primary employer.[43]

In respect of any strike or lock-out not in compliance with the Act, the Labour Court may grant an interdict, or may order payment of compensation for any loss attributable to the strike or lock-out. Participation in such a strike may constitute a fair reason for dismissal. The Act also allows for compensation to be paid in respect of losses arising from any conduct that does not comply with the provisions of the chapter of the Act relating to strikes and lock-outs.[44]

Employers may hire replacement labour to do the work of employees engaged in protected strikes if the employer's service is a designated maintenance service, or in respect of an unprotected strike. Replacement labour may be engaged only after the employer has given the trade union seven days' notice of his or her intention do so.

8.5.2 Lock-outs[45]

The employer must physically exclude employees from the workplace. The action must be to force employees to accept a demand of the employer about a matter that concerns the employer and the employees.

The procedures for a protected lock-out are the same as those for a protected strike: the issues in dispute must have been referred to a council or the CCMA, remained unresolved for 30 days, and 48 hours' written notice to the other side has been given.[46]

The effects of a protected lock-out are the employer does not commit a delict or breach of contract. Employees may not bring civil legal proceedings against an employer. For example, for loss of wages. An employer may not dismiss employees who have been locked out.

The employer may use replacement labour only if the lock-out is in response to a strike. The employer may only do so until the lock-out ends; striking employees must then get their old jobs back. An employer does not have to pay wages to an employee participating in a protected lock-out. The same provisions apply with regard to food and housing as in the case of a strike.

8.5.3 Picketing[47]

Only a registered trade union may authorise a picket. A picket may be held at any place to which the public has access outside the premises of an employer. Unions need the employer's permission to picket inside the workplace. If an employer refuses permission for a picket to take place inside the premises, the CCMA may overrule the employer if the refusal to grant permission is unreasonable taking into account the conduct of the picketers, the duration of the picket, and the number of employees taking part.

The code of good practice on picketing is a guide to those who take part in the picket and for employers, other employees or members of the public who may be affected by the picket. The code does not impose any legal obligations and a failure to observe it does not in itself render anyone liable.

The picketers must conduct themselves in a peaceful, unarmed and lawful manner and may carry placards, chant slogans and sing and dance. They may not physically prevent members of the public from gaining access to or leaving the employer's premises and they may not commit any action which may be unlawful or which may be perceived to be violent.

8.5.4 Secondary action[48]

Secondary action happens when employees strike in support of a strike by other employees.

Secondary action will be protected if the main strike is a protected strike and the secondary strikers give seven days notice to their employer or the relevant employers' organisation.[49] The nature and extent of the secondary strike must be reasonable in relation to the possible direct or indirect effect it may have on the business of the primary employer. For example, if dockworkers strike in support of striking mineworkers, their strike is unlikely to have any effect on the business of the mine owner who is the primary employer. If it has no effect, it will not be reasonable, and the dockworkers will be prohibited from holding their secondary strike.

8.5.5 Protest action to defend the socio-economic interests of employees[50]

The Act also makes provision for protected stayaways in support of socio-economic issues. The issue must be raised at NEDLAC or a similar forum and the action must be authorised by a registered union or federation. Even if these requirements are met, the Labour Court can remove protection against dismissal if participants do not comply with any order it issues to regulate the stayaway.

8.5.6 Compensation for loss attributable to industrial action

An employer or employees can claim compensation from the Labour Court if they suffer any loss as a result of an unprotected strike or lock-out or as a result of any conduct connected to the strike or lock-out that does not comply with the Act.[51]

If a union wants to avoid being sued when its members engage in unprocedural strike action, such as wild cat strikes, the union must inform the employer at the earliest possible opportunity that it disapproves of the strike and must take steps to try and persuade its members to return to work.

8.6 Workplace forums[52]

These forums are committees of employees elected by employees in a workplace. They meet employers on a regular basis for consultation on workplace issues.

The forums do not replace collective bargaining, but deal with matters that are better suited to resolution through consultation rather than through collective bargaining. These include non-wage issues, such as the restructuring of production and the introduction of new technologies.

On application from a representative trade union, the CCMA will establish a workplace forum where the employer has at least 100 employees in the workplace.

The forum will represent the interests of all employees in the workplace. A minimum of five and a maximum of 20 members will be elected. In a workplace where 1 000 or more employees are employed, the members of the forum may designate from their number one full-time member who must be paid. The forum will meet regularly during working hours. Functions will include enhancing efficiency and providing for worker participation in decision-making. The employer must meet the forum at its meetings, and once each year present a report on the employer's financial and employment situation, general performance, and future prospects and plans.

The employer must consult the forum with a view to reaching agreement on the following matters:

- New technologies and the restructuring of the workplace.
- Changes to the organisation of work.

- Partial or total plant closures.
- Mergers and transfers of ownership that may affect employees.
- Retrenchment.
- Exemptions from any collective agreement.
- Job grading.
- Criteria for merit increases or payment of discretionary bonuses.
- Education and training.
- Product development plans.
- Export promotion.

The employer is prohibited from implementing any proposal regarding the above matters until the relevant information has been disclosed and consultations with a view to reaching agreement have been held. If no agreement is reached, the employer must provide written reasons to the forum. Only after this can the employer implement the proposals. If employees remain unhappy, they can embark on protected industrial action after all the relevant procedures have been complied with.

Joint decision-making is required regarding the following matters:

- Advancement of persons disadvantaged by unfair discrimination.
- Disciplinary code and procedure.
- Rules of conduct not related to work performance of employees.
- Changes to rules of any social benefit scheme operated by the employer.

Disputes are resolved through using a procedure agreed upon by both parties, and, if unresolved, then by arbitration by the CCMA. Employees may not strike on a matter requiring joint decision-making.

The employer must disclose all relevant information to allow the forum to engage effectively in consultation and joint decision-making. Disputes relating to disclosure will be resolved by the CCMA through conciliation and, if unresolved, then by arbitration.

8.7 Trade unions and employers' organisations

Registration of trade unions and employers' organisations with the Department of Labour is voluntary. Trade unions or employers' organisations whose constitutions discriminate on grounds of race or sex cannot be registered.

8.8 Dispute resolution

8.8.1 Mediation (conciliation) and arbitration

These two concepts are important in understanding dispute resolution:

- **Mediation (or conciliation)**: Generally, the terms mediation and conciliation are interchangeable, except for a few technical differences. Mediation involves the services of an acceptable, impartial, and neutral third party to assist the parties in dealing with their dispute and, where possible, to reach agreement. The mediator (or conciliator) has no independent authority and does not make a decision. All decision-making powers with regard to the dispute remain with the parties. Conciliation is a voluntary process, both in its initiation and in its continuation. For example, the Act provides for conciliation between the employer and the employee in respect of a dismissal. A conciliator will be appointed by the CCMA, or one can be agreed upon privately between the parties.

  Conciliation proceedings are 'without prejudice' and confidential. This means that anything that is said cannot be used in any subsequent legal proceedings.[53]
- **Arbitration**: Arbitration is a process by which an impartial third party decides the issue after reviewing evidence and hearing argument from the parties. It may be binding on the parties, either through agreement or by operation of law, or it may be non-binding in that the decision may be only advisory. Arbitration may be voluntary, where the parties agree to resolve the issues by means of arbitration, or it may be compulsory, where the process, by law or other agreement, is the exclusive means provided in respect of the issues concerned.[54] For example, the Act makes arbitration in respect of individual dismissal compulsory. An arbitrator will be appointed by the CCMA, or one can be agreed upon privately between the parties.

8.8.2 Commission for Conciliation, Mediation and Arbitration (CCMA)

The CCMA was established as an independent statutory body.[55] The main functions of the CCMA are to resolve disputes by conciliation, failing which the dispute must be resolved by arbitration; provide advice and training; assist in elections and ballots; and publish guidelines and codes of good practice.

The CCMA must attempt to resolve a dispute referred to it within 30 days of the date it received the referral. This may include mediation, fact-finding, or making a recommendation to the parties in the form of an advisory arbitration award. If the matter remains unresolved a certificate is issued which allows either party to refer the matter to arbitration, or to the Labour Court on certain matters.[56]

A senior commissioner may be appointed as arbitrator where the dispute is legalistic, complex, or in the public interest, or where conflicting arbitration awards were made previously pertaining to a similar dispute. The commissioner may require any person or document necessary to be subpoenaed. If a party fails to attend the arbitration, the commissioner is entitled to make a final award.

The referral to the CCMA for arbitration, or to the Labour Court, must be made within 90 days of the certificate being issued. However, the CCMA or Labour Court may grant permission for a late referral on good cause being shown. This is known as ‘condonation’. In deciding whether or not to grant condonation, the presiding officer or judge will consider the facts and circumstances relating to the failure to refer the matter within the time limit; the lateness of the referral; the importance of the matter; the convenience of the CCMA or Labour Court; the avoidance of unnecessary delay in the administration of justice; and the applicant's prospects of success.[57]

If an unfair dismissal dispute is being arbitrated and it is alleged that the reason for the dismissal relates to the employee's conduct or capacity, then the parties may generally not be represented by a legal practitioner. However, they may both agree, or the commissioner may believe it would be unreasonable not to allow such representation. The commissioner will consider the nature of the question of law being raised by the dispute; the complexity of the dispute; the public interest; and the comparative abilities of the parties or their representatives to deal with the matter.[58]

The decision of the CCMA is called an 'arbitration award' and it must be issued within 14 days of the arbitration. The arbitration award is final and no appeal can be made against it. However, if an aggrieved party feels that the arbitrator conducted himself or herself poorly, committed a gross irregularity, or exceeded his or her powers, that party may apply for a review of the award. The Arbitration Act[59] does not apply to arbitrations conducted by the CCMA.

8.8.3 The Labour Court

The Labour Court has national jurisdiction as both a court of first instance and a court of appeal and review. Its decisions have the same status as those of the High Court and serve as precedents.[60]

The Labour Court generally will not hear a matter until it is satisfied that the parties have attempted to resolve the matter through conciliation, either through a commissioner appointed by the CCMA, a bargaining council, or an accredited agency. All the parties to a dispute in respect of which the Labour Court has jurisdiction may consent in writing to arbitration under the auspices of the CCMA.

Appeals from the Labour Court are heard by the Labour Appeal Court.

8.9 Unfair dismissal

No employee may be unfairly dismissed. Dismissal means the termination of an employment contract, the failure to renew a fixed-term contract, the refusal to allow an employee to return to work after absence due to pregnancy, as well as selective non-re-employment and constructive dismissal.

***SA Rugby (Pty) Ltd v CCMA and others*[61]**

Three rugby players claimed they were unfairly dismissed when their fixed-term employment contracts to play for the Springboks were not renewed after the Rugby World Cup in 2003.

The court held that such a termination does not constitute a dismissal unless the employee had a 'reasonable expectation' that the contract would be renewed on the same or similar terms, and the employer refused to renew it or offered to renew it on less favourable terms. The question is whether a reasonable employee in the circumstances at the time would have expected the contract to be renewed on the same or similar terms?

> The repeated renewal of a fixed-term contract or a promise that it will be renewed may give rise to such a reasonable expectation. This may be so even where the contract expressly provides that the employee will not have an expectation of renewal. This is because assurances given to an employee subsequent to entering into the contract may create such a reasonable expectation.
>
> The court held that one employee's expectation of renewal was reasonable, and two were not. The one employee had held an annual contract as well as a three-month contract for the purpose of participating in the World Cup, while the other two had only a three-month World Cup contract.

In order for the employee to succeed with a claim based on constructive dismissal, he or she must be able to prove that:[62]

- The employment contract was terminated.
- The conduct of the employer rendered the continued employment intolerable.
- The employee resigned as a result of the intolerable behaviour of the employer.
- The resignation or termination was a matter of last resort.

The employee has the onus of proving that there was constructive dismissal and that he or she did not resign voluntarily. If the employee delays too long in terminating the contract in response to the employer's intolerable conduct, he or she may be found to have waived his or her right to complain.

The requirements of procedurally fair disciplinary action are set out in the *Code of Good Practice: Dismissal*, and the explanatory memorandum to the Act. What is required is an investigation into allegations of misconduct, an opportunity for the employee concerned to respond with the assistance of a representative, a decision by the employer, and notice of the decision to the employee. The employer is required to allow an opportunity for dialogue and reflection, and does not need to conduct a mini trial.[63]

A dismissal may be fair, automatically unfair, or deemed unfair.

8.9.1 Automatically unfair dismissal

A dismissal will be automatically unfair under the Act if it was for one of the following reasons:

- The employee participated in a legally-protected strike.

- The employee refused to do work normally done by an employee participating in a legally-protected strike.
- To compel the employee to accept a demand made by the employer.
- The employee was pregnant, or any reason related to her pregnancy.
- The employer unfairly discriminated against the employee on an arbitrary ground, including race, gender, sex, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, political opinion, culture, language, marital status, or family responsibility.
- When transferring to a new business the employee was provided with less favourable conditions of employment, or the new employer does not want to accept a transferring employee.
- The employer subjects the employee to an occupational detriment for making a protected disclosure in terms of the Protected Disclosures Act.[64]

Despite this, the employer may prove that an otherwise automatically unfair dismissal is fair if the dismissal is based on an inherent requirement of the job. For example, a dismissal based on age is fair if the employee reaches normal retirement age for that job.[65]

Rubin Sportswear v SACTWU and others[66]

The court considered the meaning of 'normal' retirement age. In this case a company with a policy of normal retirement at age 60, took over another company as a going concern. The second company had no policy on retirement. Four employees aged 63, 60, 61 and 63 respectively were then notified of their retirement.

The court held that retirement age became 'normal' when employees have been retiring at that age over a certain long period. The new company was not able to declare unilaterally that 60 was the normal retirement age for all its employees. A new term and condition of employment could not be introduced without the employees' consent.

8.9.2 Deemed unfair dismissal

A dismissal that is not automatically unfair will be deemed unfair if the employer fails to prove that the dismissal was both for a fair reason connected with the employee's capacity, conduct or operational requirements; and in compliance with a fair procedure.

The onus is on the employer to prove the reason for dismissal and to justify the fairness of both the reason for the dismissal and the procedure

followed for dismissal.

8.10 Individual dismissal for misconduct or incapacity

An employee's conduct refers to the standard of behaviour that an employee must exhibit while in employment. For example, if an employee commits theft or assaults someone at work, he or she may have their employment terminated for misconduct.

A dismissal connected with the employee's conduct will be unfair unless the employer can prove the employee broke a rule regulating conduct in the workplace; the rule was reasonable or valid; the employee reasonably could be expected to have been aware of the rule; the employer consistently applied the rule; and dismissal was an appropriate sanction for the contravention of the rule.

The capacity of an employee refers to his or her ability to do the job. For example, if an employee is not able to work because of injury or illness, the employee may be incapable of doing the job for which they were employed, and may be dismissed for incapacity.

An employee may in some cases be dismissed for incapacity if he or she is unable to perform the job to the required standard, even after training has been given and reasonable opportunities been provided to improve.

A dismissal connected with the employee's capacity will be unfair unless the employer proves that:

- There was a material breach of required work standards.
- The employee was aware of the required standards.
- The employee was given a fair opportunity to meet the required standards.
- Dismissal was an appropriate sanction for the breach of the required standards.

Disputes concerning individual dismissals for incapacity or misconduct must be referred to the CCMA first for conciliation and, if unresolved, then to compulsory arbitration by a commissioner appointed by the CCMA.

The commissioner will reach a decision and, if the dismissal is found to have been unfair, the commissioner may award reinstatement, re-employment, or compensation.

CWIU and others v Latex Surgical Products (Pty) Ltd [67]

The court held that a reinstatement order could not be made for a period longer than 12 months (or 24 months in the case of an automatically unfair dismissal). The introduction of the limits on compensation in terms of section 194 of the Act also applied to back-pay amounts.

There is a conflicting Labour Appeal Court decision on this point.

Kroukam v SA Airlink (Pty) Ltd [68]

The court held that it is competent for the court to make an order for reinstatement that operates with retrospective effect up to the date of dismissal even if that goes beyond 12 or 24 months. This is presumably because the court may wish to ensure that an employee whose dismissal is substantively or automatically unfair is put in the position that he or she would have been in had the dismissal not occurred.

The issue was resolved by the Supreme Court of Appeal.

Republican Press (Pty) Ltd v CEPPWAWU and Gumede and others[69]

The Supreme Court of Appeal (SCA) considered the meaning of reinstatement. In this case the applicants had been retrenched in September 1999, and the union had caused delays that resulted in the matter only going to trial six years later. The Labour Appeal Court had earlier held that the selection criteria used for the retrenchments were not fair and objective, and that the employees had to be retrospectively reinstated with effect from September 1999.

The SCA held that remuneration due under a retrospective reinstatement award did not constitute ‘compensation’ for purposes of section 194 of the Act, and therefore was not limited to a maximum of 12 months. However, in this case it was not practical to reinstate the employees after so long, and so the court ordered the employer to pay them compensation instead.

Where reinstatement is ordered in terms of a substantively unfair dismissal, the Act does not cap the retrospective effect, and back-pay must be paid to the date of the dismissal, no matter how long ago that was. Depending on when the matter is finally adjudicated, the potential liability for an employer can be huge.

However, when a dismissal was only procedurally unfair, or where reinstatement is not practical, then the maximum amount of compensation is capped to an amount equal to a maximum of 12 months for an unfair dismissal, or a maximum of 24 months in respect of an automatically unfair dismissal.

8.11 Disputes concerning dismissal for operational requirements[70]

In disputes concerning dismissal of one or more persons for operational requirements, a distinction is made between retrenchments of individuals, retrenchments at small scale businesses, and retrenchments at large scale businesses.

When an employer contemplates a dismissal for operational reasons, the employer must issue a written notice inviting the other consulting parties to consult with it and must disclose all relevant information including:

- The reasons for the dismissals.
- The alternatives considered.
- The number of employees likely to be affected.
- The proposed method for selecting which employees to dismiss.
- When the dismissals are likely to take effect.
- The severance pay proposed.
- Any assistance that the employer proposes to offer to the employees likely to be dismissed.
- The possibility of future re-employment.
- The number of employees employed by the employer.
- The number of employees that the employer has dismissed for reasons based on its operational requirements in the last 12 months.

The parties must engage in a meaningful joint consensus-seeking process.[71] The employer must disclose all relevant information for purposes of consultation. The employer bears the onus of proving that any information of which disclosure is refused is not relevant.

The employer must allow the other consulting parties to make representations about these matters and any other matters. The employer must consider and respond to any representations that are made. If they were made in writing, the employer must respond in writing.

8.11.1 The process for large-scale retrenchments[72]

Section 189A of the Act applies to workplaces where an employer employs more than 50 employees and where the number of retrenchments contemplated meet a certain minimum threshold over a 12-month period. For example, if an employer employs 190 employees but only contemplates dismissing 9 then section 189A is not applicable. However, if the same employer is contemplating 12 dismissals, section 189A would be applicable.

Table 24.3 *Minimum number of employees retrenched for section 189 to apply*

Number of employees employed	Minimum number of dismissals contemplated for section 189A requirements to apply
50–200	10 or more
201–300	20 or more
301–400	30 or more
401–500	40 or more
500 or more	50 or more

In terms of section 189A, the employer or the consulting parties may request the appointment of a facilitator from the CCMA to assist the parties during the consultation process. Once a facilitator has been appointed, the employer may not issue notices of termination for 60 days after giving the notice to consult. The registered trade union or the employees concerned may then give notice of a strike or may refer a dispute to the Labour Court.

If neither party has requested the CCMA to appoint a facilitator, then the dispute may not be referred to a council or the CCMA for 30 days from the date of the notice to consult. Once the period for conciliation is finished (30 days or when a certificate is issued), the employer can give notice of termination and the union or employees can give notice of a strike. The choice of strike action or adjudication by the Labour Court is an important decision – once made, it cannot be withdrawn and the other option cannot be instituted.

If a consulting party challenges the substantive fairness of the dismissals in the Labour Court then the test for substantive fairness is limited to whether:

- The dismissals were to give effect to an operational requirement.
- The dismissals were justifiable on rational grounds.
- There was a proper consideration of alternatives.
- The selection criteria were fair and objective.

SATAWU v Old Mutual Life Assurance Company South Africa Limited [73]

The employer proposed the outsourcing of certain parts of the company. Those employees who could not be accommodated elsewhere in the operation or with subcontractors were either retrenched or they accepted early retirement. Employees who were retrenched argued their dismissals were unfair in that there was no proper operational requirement to retrench them.

The court held that firstly, it had to consider the content of the reasons given in order to ensure that they were not arbitrary and were aimed at a commercially acceptable objective. Secondly, there had to be a rational connection between the employer's scheme and the commercial objective. Through the consideration of alternatives, an attempt should be made to find the alternative that least harmed the rights of employees. The alternative eventually applied did not need to be the best means or the least drastic measure, but it had to fall within a range of reasonable options available to the employer.

The court held that there was nothing to suggest that the decision to outsource was not for a legitimate, commercially justifiable objective, or that it was arbitrary or capricious in any way. The court noted that the applicant never questioned the rationale for outsourcing nor did it make any suggestions for an alternative strategy. Furthermore, the applicant never questioned the respondent's designation of core and non-core functions. Its allegations that the retrenchments were substantively unfair were therefore dismissed.

8.11.2 The referral of a dispute by employees at a small-scale operation[74]

Employees may refer a dispute over the substantive and/or procedural fairness of retrenchments to the Labour Court, if section 189A is not applicable. This is the case if the employer has fewer than 50 employees or if the number of dismissals contemplated is less than the threshold figure.

8.11.3 The referral of a dispute by a single employee

A single employee who has been retrenched may choose to refer a dispute either to arbitration or to the Labour Court.

8.11.4 Severance pay

In terms of the Basic Conditions of Employment Act,[75] dismissal for operational requirements entitles an employee to severance pay of one week's remuneration for each completed year of continuous service.

The consulting party may reach agreement on a higher amount. An employee who unreasonably refuses to accept an employer's offer of alternative employment with that employer or any other employer is not entitled to severance pay.

8.12 The transfer of a business as a going concern

The new employer takes over the employees' contracts of employment from the old employer. This happens automatically on transfer of the business unless there is an agreement to the contrary between the employers and the appropriate employee representatives.

***Telkom Ltd and others v Blom and others*[76]**

A division of Telkom was transferred as a going concern to a new owner. The court had to determine whether employees of Telkom and members of its pension fund were entitled to their pension fund benefits.

The court held that when a business or part thereof is transferred as a going concern the new owner takes over the employees and is by operation of law substituted in the place of the old employer. The original employer falls out of the picture and, as between him and the employees, the contract is extinguished. Therefore pension benefits of employees become payable as their employment with the transferor has come to an end. Such benefits cannot be transferred to the transferee without the consent of the employees.

The transfer of a business as a going concern is an assignment of employment contracts but not of the pension benefits. An employee's continuity of employment is not interrupted by the transfer of the business. The new employer must employ the employees on terms and conditions that are on balance not less favourable than those which employees enjoyed with the old employer. However, if the terms and conditions of employment of the transferred employees are determined by collective agreement, the collective agreement continues to apply.

***Securicor (SA) (Pty) Ltd and others v Lotter and others*[77]**

The court held that in deciding whether a restraint of trade agreement survived the transfer of a business under section 197 of the Labour Relations Act,[78] it had to be determined as a matter of fact whether the restraint formed part of the goodwill of the business and whether that goodwill formed part of the business being transferred as a going concern. If that factual enquiry established that the restraint formed part of the transfer of the business the employee's obligations under the restraint were owed to the new employer who was entitled to enforce the restraint against the employee.

The old employer must reach agreement with the new employer as to a valuation on the date of transfer of the transferring employees' accrued leave pay; severance pay (had the employees been entitled to severance pay); and any other accrued entitlements, such as bonuses.

For a period of 12 months after the date of transfer both the old employer and the new employer are liable to any employee who becomes entitled to a payment as a result of being dismissed for operational requirements or as a result of the employer's liquidation or sequestration.

The new employer becomes liable for any unfair dismissal, unfair labour practice or act of discrimination committed prior to the transfer by the old employer. These provisions place a burden on the new employer and the new employer should factor into the purchase price the potential financial costs of transferring employees on.

8.13 The transfer of contracts of employment in circumstances of insolvency[79]

When a business becomes insolvent and a scheme of arrangement is entered into to avoid the winding-up or sequestration of the business, employees' contracts of employment transfer from the old employer to the new.

The new employer is automatically substituted in the place of the old employer but all the rights and obligations between the old employer and its employee at the time of transfer remain with the old employer.

8.14 Enforcement of awards

The CCMA and bargaining councils may hand down arbitration awards which are final and binding, and that can be enforced as if they were orders of the Labour Court.

8.15 Residual unfair labour practices

Unfair labour practices are defined as any unfair act or omission arising between an employer and an employee (or an applicant for employment) involving any of the following:

- Unfair discrimination, either directly or indirectly, against an employee on any arbitrary ground, including but not limited to race; religion; gender; conscience; sex; belief; ethnic or social origin; political opinion; colour; culture; sexual orientation; language; age; marital status; disability; or family responsibility.
- Any discrimination based on an inherent requirement of the job does not constitute unfair discrimination.
- Unfair conduct of an employer relating to the promotion, demotion, or training of an employee, or relating to the provision of benefits to an employee.[80]
- An employer is not prevented from adopting or implementing employment policies and practices that are designed to achieve the adequate protection and advancement of persons, groups, or categories of persons disadvantaged by unfair discrimination, in order to enable their full and equal enjoyment of all rights and freedoms.

Stokwe v MEC, Department of Education, Eastern Cape Province and another **81**

The applicant applied for a promotion to the post of principal at a primary school. She and a coloured male scored equally in the interview. She was better qualified in psychology than the male applicant which resulted in her being the preferred candidate.

The school governing body changed the preference list so that the applicant ranked second because of concerns about her ability to speak Afrikaans. A review panel of three white Afrikaans-speaking principals was convened and the applicant attended another interview. She refused to speak Afrikaans during the second interview. The panel queried her ability to compete, as a woman, against men, and they informed her that 50 per cent of the staff did not want her.

The male applicant was appointed and the applicant challenged her non-promotion on the basis of unfair discrimination.

The court held that the school governing body had assumed that, as a black person, the applicant would not be proficient in Afrikaans. Such stereotyping was an obvious manifestation of bias and prejudice and was a typical form of unlawful discrimination.

Protecton (Pty) Ltd v CCMA and others[82]

> An employee enjoyed travel concessions in terms of an employment policy which provided that the rules governing the grant of the concessions could be changed unilaterally. The employer unilaterally withdrew the travel concessions and replaced them with an increase in remuneration amounting to one-third of the value of the concessions.
>
> The court held that disputes over the provision of benefits may fall into two categories: Firstly, where the issue concerns a demand that a new employment right be created, and, secondly, where the issue concerns the fairness of the employer's conduct regarding an existing right. Disputes that fall in the first category cannot be referred to arbitration and must be resolved by means of collective bargaining. Disputes that fall in the second category may be referred to arbitration in terms of section 186(2)(a). Where the employer enjoys a contractual discretion in relation to the granting of benefits, the purpose of section 186(2)(a) is to ensure that the employer exercises its discretion fairly. Where the discretion is exercised unfairly, the employee has the unfair labour practice remedy provided for in section 186(2)(a). While the applicant had a fair operational reason for the withdrawal of the concessions, the withdrawal was procedurally unfair because the applicant had failed to consult on the rationale for the withdrawal.

- Unfair suspension of an employee or any other disciplinary action against any employee short of dismissal.
- Failure or refusal of an employer to reinstate or re-employ a former employee in terms of any agreement.
- An occupational detriment, other than dismissal, being applied to an employee who has made a protected disclosure in terms of the Protected Disclosures Act.[83]

A dispute may be referred for conciliation to the relevant bargaining council with jurisdiction, or to the CCMA. If the dispute remains unresolved, then if it concerns unfair discrimination it must be forwarded to the Labour Court for adjudication; other disputes must be forwarded to the CCMA for arbitration.

9 Employment Equity Act[84]

The purposes of this Act are to:

- Promote equal opportunity and fair treatment in employment through the elimination of unfair discrimination.
- Implement affirmative action measures to redress the disadvantages in employment experienced by designated groups, in order to ensure their equitable representation in all occupational categories and levels in the workforce.

In terms of the Act, ‘designated groups’ means black people, women, and people with disabilities. ‘Black people’ is a term that means Africans, coloureds and Indians. The definition of ‘designated groups’ has been limited to natural persons who are citizens of South Africa by birth, descent or by naturalisation.[85] The effect is that foreigners who otherwise fit the definition of belonging to designated groups, will not count towards a designated employer's numbers for purposes of employment equity.

The Act does not apply to members of the National Defence Force, the National Intelligence Agency, or the South African Secret Service.

In terms of the State Tender Board Act,[86] an employer wishing to submit any tender in respect of a State contract will be required to produce a certificate that the employer complies with the Act.

The main provisions of the Act are as follows:

9.1 Prohibition of unfair discrimination

Every employer must try to take steps to promote equal opportunity in the workplace by eliminating unfair discrimination in any employment policy or practice:

- **Prohibition of unfair discrimination**: No person may unfairly discriminate, directly or indirectly, against an employee, in any employment policy or practice, on one or more grounds, including race, gender, sex, pregnancy, marital status, family responsibility, ethnic or

social origin, colour, sexual orientation, age, disability, religion, HIV status, conscience, belief, political opinion, culture, language, and birth.

It is not unfair discrimination to take affirmative-action measures consistent with the purposes of the Act, or to distinguish, exclude, or prefer any person on the basis of an inherent requirement of a job.

Harassment is a form of unfair discrimination, as is a difference in terms and conditions of employment between employees of the same employer performing the same or substantially the same work or work of equal value. The *Amended Code of Good Practice on the Handling of Sexual Harassment Cases in the Workplace* expressly states that sexual harassment is a form of unfair discrimination.

- **Medical testing**: All medical testing is prohibited unless it is allowed or required by legislation, or is justifiable in the light of medical facts, employment conditions, social policy, the fair distribution of employee benefits, or the inherent requirements of the job. The test must also have been certified by the Health Professions Council of South Africa established in terms of the Health Professions Act.[87]
- **Testing of HIV status**: This is prohibited unless express prior approval is obtained from the Labour Court. In these cases, the Labour Court may make an order regarding counselling, maintenance of confidentiality.
- **Psychological testing**: All psychological tests are prohibited unless they can be proved to be scientifically valid and reliable, are applied fairly to all employees, and are not biased against any employee or group.

A party to any dispute regarding unfair discrimination may refer the matter to the CCMA for conciliation within six months. If still not resolved, a party may refer the dispute to the Labour Court for adjudication. However, the dispute may be referred to the CCMA for arbitration instead if the employee earns less than the threshold of R172 000 set out in the Basic Conditions of Employment Act.[88]

The employer must prove the fairness of any discrimination or any test. Even if the employer's conduct was not prohibited on one of the grounds specified in the Act, it can still be found to be unfair discrimination if it undermines human dignity or perpetuates disadvantage in the workplace.

9.2 Affirmative action

Affirmative action measures are designed to ensure that suitably qualified people from designated groups have equal employment opportunities and are equitably represented in all occupational categories and levels in the workforce of a designated employer.

A ‘designated employer’ is one with 50 or more employees, or one with an annual turnover, in millions of rands, greater than a defined level: Agriculture at R5 million; Mining at R7.5 million; Manufacturing at R10 million; Electricity at R10 million; Construction at R5 million; Retail trade at R15 million; Wholesale trade at R25 million; Catering at R5 million; Transport at R10 million; Finance at R10 million; and Community Services at R5 million.[89]

Every designated employer must consult with its employees and conduct an analysis by reviewing its employment policies, practices, procedures and the working environment in order to identify employment barriers which adversely affect people from designated groups. A designated employer must also prepare an employment equity plan taking into account the relevant Codes of Good Practice, and report to the Director-General of the Department of Labour on progress made in implementing the employment equity plan.

Affirmative action measures include: measures to identify and eliminate employment barriers that unfairly affect people from designated groups, including unfair discrimination; measures designed to further diversity in the workplace based on equal dignity and respect of all people; making reasonable accommodation for people from designated groups; measures to ensure the equitable representation of suitably qualified people from designated groups in all occupational categories and levels in the workforce; and measures to retain and develop people from designated groups and to implement appropriate training measures. These measures include preferential treatment and numerical goals, but exclude quotas. A person will be suitably qualified as a result of any formal qualifications, prior learning, relevant experience, or capacity to acquire – within a reasonable time – the ability to do the job.

The Act describes the reasonable steps that designated employers must take to consult and attempt to reach agreement with the representative trade union. If there isn't one, the employer must consult with representatives of the employees, who must reflect the interests of all occupational categories

and levels of employees and both designated and non-designated groups. Matters for consultation include the conduct of the analysis, the preparation, and the implementation of the employment equity plan and the employment equity report.

The designated employer must collect information and conduct an analysis of its employment policies, practices, procedures, and the working environment, in order to identify employment barriers that adversely affect people from designated groups. The analysis must include a profile of the workforce within each occupational category and level to determine the degree of under-representation of people from designated groups.

The employment equity plan must state the objectives for each year of the plan; affirmative action measures to be implemented; numerical goals to overcome under-representation at any occupational category and level; timetable for the achievement of these goals and strategies intended to achieve these goals; timetable for each year of the plan; duration of the plan (between one and five years); procedures used to monitor progress and to evaluate implementation; internal procedures to resolve any dispute about the interpretation or implementation of the plan; and the persons – including senior managers – responsible for monitoring and implementing the plan.

A designated employer must submit its report to the Director-General every year in October. Every designated employer that is a public company must publish a summary of the report in its annual financial statements.

One or more senior managers must be responsible for the monitoring and implementation of the employment equity plan. The employer must display in a prominent and accessible place at the workplace a summary of the provisions of the Act, and a copy of the most recent employment equity report submitted to the Director-General.

A designated employer must submit a statement to the Employment Conditions Commission of the remuneration and benefits received in each occupational category and level of the workforce. Where the income differentials are deemed disproportionate, measures must be taken by the employer to reduce the extent of the disproportion.

The Director General may apply to the Labour Court for a fine to be imposed if the employer fails to prepare and implement an employment equity plan.

9.3 Monitoring, enforcement, and legal proceedings

Contraventions of the Act may be brought to the attention of a labour inspector, who may issue a compliance order that requires the employer to:

- Consult with employees.
- Conduct an analysis.
- Publish a summary of its report.
- Assign responsibility to one or more senior managers.
- Inform its employees of the provisions of the Act.
- Maintain records.
- Prepare and implement an employment equity plan.

If the employer does not comply with the compliance order, the Director-General may modify or amend the order, or apply to the Labour Court to make the compliance order an order of court.

The Labour Court may make any order it deems just and equitable, and may order the employer to take steps to prevent the same unfair discrimination or similar practice occurring in the future, or may order the payment of damages or compensation to the employee. The maximum permissible fines that may be imposed for contravening the Act are set out below.

Table 24.4 *Fines that may be imposed for contravening Employment Equity Act*

Previous contravention	Maximum fine
No previous contravention.	2% of turnover
A previous contravention in respect of the same provision.	4% of turnover
A previous contravention within the previous 12 months or two previous contraventions in respect of the same provision within three years.	6% of turnover
Three previous contraventions in respect of the same provision within three years.	8% of turnover
Four previous contraventions in respect of the same provisions within three years.	10% of turnover

‘Turnover’ means the total annual turnover of an employer for the preceding year calculated in terms of the Competition Act.[90]

Any contravention of any of the affirmative-action provisions of the Act may lead to a fine that ranges from up to R500 000 on no previous contravention, to up to R900 000 on four previous contraventions in respect of the same provision within the previous three years.

9.4 Defences against discrimination

The Employment Equity Act[91] set out two grounds justifying discrimination:

- Affirmative-action measures.
- Inherent requirements of the job.

The court has recognised a further defence to discrimination. This is a general defence based on the principle of equity or fairness. Discrimination will be unfair if it is reprehensible in terms of society's prevailing norms. Whether or not society will tolerate discrimination depends on what the purpose is of the discrimination and the means used to achieve it. The purpose must be legitimate and the means proportional and rational.[92]

***Stoman v Minister of Safety and Security and others*[93]**

The applicant was a white employee who applied to court to review the appointment of a black employee. The applicant had scored the highest number of points in the interview process and had been recommended for the promotion. The black candidate, who was the most suitable for the position amongst the black applicants, was appointed. The Minister denied that the applicant had been unfairly discriminated against. The Minister claimed that in appointing the best black applicant he had given effect to the Employment Equity Plan drawn up in accordance with the Act. Though the applicant in court claimed that he was better qualified for the position than the black employee, it was not alleged that the black employee was not qualified at all for the position. The applicant also claimed that there was no proof that the black employee, as an individual, had been previously disadvantaged.

The court did not agree that representivity would only play a role where competing candidates have broadly the same qualifications and merits. The court held that some tension may exist between ideals such as efficiency and representivity, and a balance then has to be struck. The advancement of equality was held to be inevitably part of the consideration of merits in decision-making processes. Efficiency will only be more important than representivity where the appointment of the representative candidate would be rationally justifiable on account of such qualifications, suitability or ability.

The court held that the particular privileges or achievements of a person falling within the designated category should not be taken into account when affirmative-action measures are applied. The aim of the Act was not to reward the respondent as an individual, but to advance a category of persons to which he belongs and to achieve substantive equality in the SAPS as an important component of South African society. Similarly, the aim was not to punish or otherwise prejudice the applicant as an individual, but to diminish the over-representation which his group has been enjoying as a result of previous unfair discrimination.

Coetzer and others v Minister of Safety and Security and another [94]

The applicants were inspectors in the bomb squad of the SAPS. The SAPS had refused to appoint them in posts reserved for a designated group. The SAPS refused to process their applications for appointment, despite the fact that it was not able to fill a large number of posts reserved for the designated group in the bomb squad. The applicants challenged this decision on the basis that the refusal to process the applications constituted unfair discrimination. The SAPS relied on their employment equity plan as justification for the refusal.

The court recognised that the application of the employment equity plan could constitute justification for the alleged unfair discrimination. However, it was necessary that the SAPS should interpret and apply its equity plan in accordance not only with the equality and affirmative action provisions of the Constitution, but with all the provisions of the Constitution, which provided that the SAPS was obliged to discharge its responsibilities effectively. The court held that the Constitution envisages a balance between affirmative action and the need for the police service to discharge its responsibilities effectively. The Constitution did not prescribe how these two imperatives ought to be balanced but the balance must be a rational one.

The court held that a designated employer may not place a blanket ban on the employment or promotion of able-bodied white males in order to achieve the numerical goals. The employer, being the State, also had to show that its affirmative-action measures were consistent with other constitutional provisions. The failure to balance affirmative-action measures and the requirement that the SAPS discharge its responsibilities effectively, was not rational. Accordingly the SAPS's failure to promote applicants could not be justified by its defence that it had complied with its employment equity plan.

Employment equity measures to improve representivity should not be haphazard or random, as this would not be considered to be rational or to justify discrimination.

SA Police Union obo Du Toit and SA Police Service[95]

The Commissioner had to decide whether the SAPS's failure to appoint the best white candidate on the basis of affirmative action, constituted discrimination. The SAPS had failed to promote a white employee to a non-designated post. Instead they had appointed a person from the designated category to the non-designated post on the basis of the SAPS wishing to advance its representivity in terms of its employment equity plan.

The applicant argued that representivity was not relevant regarding an appointment to a position which was categorised as non-designated. This would negate the whole purpose and object of having the category, and would exclude non-designated applicants from applying for both non-designated and designated positions.

The Commissioner found that the SAPS had not applied the criteria laid down in its own employment equity plan fairly or correctly and held that the failure to promote the applicant amounted to unfair discrimination.

10 Protected Disclosures Act[96]

The Act makes provision for procedures for employees to disclose information about unlawful or irregular conduct by their employers or other employees in the workplace. This includes information about any current, past or future:

- Criminal offence.
- Failure to comply with a legal obligation.
- Miscarriage of justice.
- Health and safety endangerment of an individual.
- Damage to the environment.
- Unfair discrimination in terms of the Promotion of Equality and Prevention of Unfair Discrimination Act.[97]

Any dismissal will be deemed an automatically unfair dismissal in terms of the Labour Relations Act.[98] Any other occupational detriment is deemed to be an unfair labour practice in terms of that Act.

PRACTICALLY

SPEAKING

How to avoid spending money on employee salaries when you do not have any cash

The simplest way to start your new business is to work from home, and to work for yourself by being the only employee. That way, you can grow the business after you make profits from what you sell, instead of borrowing money. However, for some businesses it is not possible to grow without employing several people to do the work. For example, if you want to run a food shop you may find it too exhausting to keep open for 14 hours a day, seven days a week. Some customers may become impatient if they have to wait while you serve others; and sometimes your administration can suffer if you are always in front of customers and never ordering stock and dealing with suppliers and all the other things you need to do to make the new business succeed.

What are the alternatives to spending money on paying people wages?

- **Wait until the work is available before hiring someone**: It makes sense to employ someone only once there is enough work for them to do. However, how do you cope

until then? Increasing the workload of the current employees may be more expensive in the long run as their workload causes stress and may result in someone leaving.

- **Hire someone to make money**: Your new hire should be someone who generates work or sales. Set clear goals for them so that they are able to make a contribution to your new business instead of being an overhead, and follow-up often. Salespeople in particular can have high expenses and may take a long while to convert prospective customers into actual clients.
- **Use alternate forms of employment**: Casual workers, fixed-term employees, part-time employees or contractors can be used instead of hiring someone full time. If your business needs staff for a few specific hours of the day or week, then part-time employees may be the best solution for you.
- **Parents and retirees**: Housewives and people who have retired can be an excellent source of good workers with excellent skills. Some parents may be able to work before or after their children go to school, or at night.
- **Volunteers and interns**: It may be possible for you to attract students and graduates to work for you for nothing just to get relevant experience. After they become proficient, and your business grows, they may be considered for paid employment.
- **Pay for performance**: It may be possible for you to structure your remuneration system so that some people are given very low base rates of pay, and higher levels of performance incentives and bonuses based on their performance. Typically found in sales jobs, this kind of salary structure can be unpopular in other areas.
- **Give away a share of your business**: Sometimes a talented employee may accept less money in exchange for a share of the business, or an option to purchase a share. Apart from the problem of losing control of how the business is run, it may also create problems if you want to get rid of the person later. It is much harder to get rid of a shareholder than an employee! It makes sense to speak to your attorney before giving away any part of your business.

THIS CHAPTER IN ESSENCE

1 The Basic Conditions of Employment Act lays down minimum and maximum standards that must be complied with by an employer. This includes: regulation of working time; leave; providing particulars of employment and methods of calculating remuneration; and termination of employment.
2 The Occupational Health and Safety Act provides for the health and safety of persons at work and in connection with the use of plant and machinery; protection against hazards to health and safety arising from activities of people at work; and the establishment of an advisory council for occupational health and safety.
3 The Unemployment Insurance Act provides for the establishment and administration of a central fund, financed through compulsory contributions by employers, employees, and the State. Benefits provided include: unemployment benefits; illness benefits; and maternity, adoption and dependent's benefits. Benefits are not taxed and are paid on a sliding scale according to remuneration.
4 The Unemployment Insurance Contributions Act creates a duty on every employer and every employee to whom it applies to contribute to the Unemployment Insurance Fund on a monthly basis. Both employer and employee must each pay one per cent of the remuneration due to the employee during any month.
5 The Skills Development Act aims to increase levels of investment in education and training in the labour market.
6 The Skills Development Levies Act requires every employer to pay a skills development levy at a rate of one per cent of the total amount of remuneration due by an employer to its employees during any month.
7 The Compensation for Occupational Injuries and Diseases Act provides compensation for disablement caused by occupational injuries or diseases sustained or contracted by employees during the course of employment. Payouts are

calculated on a scale, according to particular maximum earnings per year, in the event of temporary or permanent disability, or serious disfigurement arising from injuries suffered or diseases contracted in the course of employment.

8 The Labour Relations Act promotes orderly collective bargaining and the effective resolution of disputes. It does this by providing for centralised bargaining through: collective agreements; bargaining councils; and statutory councils. It also promotes organisational rights and the ability to take industrial action in the form of strikes or lock-outs. Picketing and secondary action is also regulated. The Act further provides for resolution of industrial disputes through conciliation and arbitration. The Act distinguishes between unfair dismissals, and automatically unfair dismissals. Individual dismissal can occur for misconduct, incapacity, or for operational requirements. Different procedures are created for retrenchments from small scale businesses and large scale businesses.

9 The Labour Relations Act also regulates transfers of businesses, whether or not as going concerns.

10 The Commission for Conciliation, Mediation and Arbitration is established as an independent body to resolve disputes by conciliation, failing which the dispute must be resolved by arbitration; provide advice and training; assist in elections and ballots; and publish guidelines and codes of good practice.

11 The Labour Court has national jurisdiction as both a court of first instance and a court of appeal and review. Its decisions have the same status as those of the High Court and serve as precedents.

12 The Employment Equity Act prohibits unfair discrimination, and requires employers to implement affirmative action measures to redress the disadvantages in employment experienced by designated groups, in order to ensure their equitable representation in all occupational categories and levels in the workforce.

QUESTIONS

Short questions (1–5 marks)

1 What is the normal maximum ordinary hours that an employee may work on any day?
2 Describe how sick leave is regulated.
3 Is it legal to make deductions from an employee's wage or salary?
4 What does ‘payment in lieu of notice’ mean?
5 List five requirements by employees in terms of the Occupational Health and Safety Act.
6 List three categories of employee that are excluded from the Unemployment Insurance Act.
7 What is the threshold for payment of monthly and annual contributions in terms of the Unemployment Insurance Contributions Act?
8 What is the monthly amount of the skills development levy?
9 How are employers assessed for purposes of calculating their payments to the Compensation Fund in terms of the Compensation for Occupational Injuries and Diseases Act?
10 What are organisational rights in terms of the Labour Relations Act?
11 What is a closed-shop agreement?

Paragraph questions (5 marks)

1. Discuss the operation of the Employment Equity Act in South Africa.
2. Distinguish between mediation and arbitration and when each is appropriate.
3. Distinguish between a strike and a lock out.
4. Discuss what is meant by an automatically unfair dismissal and an unfair dismissal, and the remedies for each.
5. Discuss various categories of dismissal: for misconduct, for incapacity, or for operational requirements.
6. Describe the CCMA and its functions.
7. Discuss fully what is meant by a workplace forum and how it is meant to operate.
8. Discuss what is meant by a bargaining council and how it is meant to operate.

Essay questions (10 marks)

1. Describe the regulation of the Basic Conditions of Employment Act.
2. Describe the regulation of the Unemployment Insurance Act.
3. Describe the regulation of the Labour Relations Act.
4. Analyse the effectiveness of the Employment Equity Act in prohibiting unfair discrimination.

Problem questions (20 marks)

1. Lerato is given one month's notice when her employer discovers she is pregnant. Brian is dismissed when his employer finds out that he suffers from epileptic fits, a condition he did not reveal when he was employed. Advise Lerato and Brian.
2. Beauty works as a domestic worker for the Adams family. She demands a written contract of employment, and a pension fund. Advise Mrs Adams.
3. Peter is the manager of a butchery shop. He makes sexual advances to Paul, a junior clerk at the shop. When Paul objects, Peter fires him without a hearing. Paul goes to his union. The union goes on strike immediately and demands that Peter be dismissed. Advise the owner of the shop.
4. Pindiswa goes to the doctor and is told she needs an operation. She gets a medical certificate booking her off work for three months. When she returns to her work she is told there is no job for her as she deserted. Advise her.
5. Moses owns a hardware store that employs five people, all of whom belong to the union. Times are bad and he wants to retrench two employees. Advise him.
6. A truck-driving company employing 300 white men wants to know about employment equity and affirmative action. Must the men be fired and only black women hired in their place?
7. Ben plans to go on holiday with his family over December. He applies for leave and is granted the leave. In November he is told the leave is cancelled and he must work in December. Advise Ben.
8. Elizabeth applies for a job and tells the people interviewing her that she has eleven children to take care of. She does not get

the job. Advise her of her rights and remedies.

9. Sipho is the owner of a taxi. He employs Kgomotso as a driver. When Kgomotso tells him he wants to join a union, Sipho fires him on the spot. Advise Kgomotso.
10. Zelda has worked in a dusty factory for 37 years and gets a lung disease. Management wants to dismiss her for medical incapacity. Advise management.
11. You are a manager in an office and the performance of one of the employees is not satisfactory. You are considering whether her employment should be terminated.
    a. Discuss how you would go about this.
    b. Would your answer be different if she tells you she has TB?
    c. Would your answer be different if this is her third week on the job?
    d. Would your answer be different if this is her 35th year on the job?
12. Johan works for a coal mine that employs over 2 000 people. He has worked there for the past seven years. They give him a letter saying that he is retrenched, together with 600 other workers, because of the international exchange rate. His union is very angry. They come to your office for advice on what they can do.
13. Moses is a very tough union shop steward. During wage negotiations he sends a letter to the Managing Director asking for disclosure of the company's financial statements. She tells him that he has no education and could not understand the figures, and then she fires him for being a ‘troublemaker’. Advise the union.
14. Stoffel, an unemployed white man, decides he has had too much difficulty getting a job when all the good jobs are reserved for affirmative action candidates. He normally wears glasses, but throws them away and applies for an ‘Employment Equity’ job on the basis that he is disabled. When he does not get the job, he decides to take the company to court. Advise him.
15. A job advertisement appears in the newspaper that reads: ‘This company has a policy of only appointing women; no man need ever bother to apply’. Discuss.

1 Basic Conditions of Employment Act 75 of 1997.

2 *Government Notice* R1295 in *Government Gazette* 20587/5-11-1999.

3 Public Holidays Act 36 of 1994.

4 *Government Notice* R422 in *Government Gazette* 34287/13-5-2011.

5 *Mondi Packaging (Pty) Ltd v Director-General: Labour and others* [2010] 11 BLLR 1131 (LAC).

6 Unemployment Insurance Act 63 of 2001.

7 *Government Notice* R1295 in *Government Gazette* 20587/5-1-1999.

8 *Irvin and Johnson Ltd v CCMA and others* [2006] 7 BLLR 613 (LAC).

9 Occupational Health and Safety Act 85 of 1993.

10 Mines and Works Act 27 of 1956.

11 Explosives Act 26 of 1956.

12 *Government Notice* R10, Diving Regulations; *Government Notice* R109, Explosives Regulations; *Government Notice* R295, Driven Machinery Regulations; *Government Notice* R307, Noise Induced Hearing Loss Regulations; *Government Notice* R533, Certificate of Competency; *Government Notice* R797, Lift Escalator and Passenger Conveyor Regulations; *Government Notice* R1179, Hazardous Chemical Substances; *Government Notice* R1390, Hazardous Biological Agents; *Government Notice* R1591, Vessels under Pressure Regulations; *Government Notice* R1593, Electrical Machinery Regulations; *Government Notice* R1593, Facilities Regulations; *Government Notice* R2281, Environmental Regulation for Workplaces; *Government Notice* R2920, Electrical Installation Regulations.

13 Unemployment Insurance Act 63 of 2001.

14 Skills Development Act 97 of 1998.

15 Compensation for Occupational Injuries and Diseases Act 130 of 1993.

16 Skills Development Act 97 of 1998.

17 Basic Conditions of Employment Act 75 of 1997.

18 Income Tax Act 58 of 1962.

19 Compensation for Occupational Injuries and Diseases Act 130 of 1993.

20 Labour Relations Act 66 of 1995.

21 Schedule 3: Scale of contributor's entitlement to benefits (section 12(2)), Unemployment Insurance Act 63 of 2001.

22 Unemployment Insurance Contributions Act 4 of 2002.

23 Income Tax Act 58 of 1962.

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25 Skills Development Levies Act 9 of 1999.

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27 Basic Conditions of Employment Act 75 of 1997.

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29 *Union Government v Matthee* 1917 AD 68.

30 *Urquhart v Compensation Commissioner* [2006] 1 BLLR 96 (E).

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32 Venter et al., *Labour Relations in South Africa*, third edition, Cape Town: Oxford University Press 2008.

33 *Bhoer v Union Government* 1956 (3) SA 582 (C).

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38 Ibid.

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40 Ibid.

41 Ibid.

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43 *South African Local Government Association v South African Municipal Workers Union* (LAC) (unreported case no JA 26/07, 29-3-2011).

44 *Jumbo Products CC v NUMSA* (1996) 17 ILJ 859 (W); *Kgasago and others v Meat Plus CC* (1999) 5 BLLR 424 (LAC); *Stutterfords Department Stores Ltd v SACTWU* (2001) 1 BLLR 46 (LAC); *Rustenburg Platinum Mines Limited v Mouthpiece Workers Union* (2002) 1 BLLR 84 (LC).

45 *Know Your LRA - A Guide to the Labour Relations Act 1995 (as amended)* second edition, Department of Labour August, 2002.

46 *Business South Africa v COSATU and another* (1997) 18 ILJ 474 (LAC).

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49 *CWIU v Plascon Decorative (Inland) (Pty) Ltd* 1999 (20) ILJ 321 (LAC).

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51 *Alert Employment Personnel (Pty) Ltd v Leech* (1993) 14 ILJ 655 (LAC).

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53 *Hofmeyr v Network Healthcare Holdings (Pty) Ltd* (2004) 3 BLLR 232 (LC).

54 Pretorius, 1993.

55 *Carephone (Pty) Ltd v Marcus NO and others* (1998) 19 ILJ 1425 (LAC).

56 *NUMSA and another v Cementation Africa Contracts (Pty) Ltd* 1998 (19) ILJ 1208 (LC).

57 *Melane v Santam* 1962 (4) SA 531 (A).

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60 *Coin Security Group (Pty) Ltd v SANUSOW and others* (1998) 19 ILJ 43 (C).

61 *SA Rugby (Pty) Ltd v CCMA and others* [2006] 1 BLLR 27 (LC).

62 *Murray v Minister of Defence* 2007 (3) SA 374 (C).

63 *Avril Elizabeth Home for the Mentally Handicapped v CCMA and others* (2006) 9 BLLR 833 (LC).

64 Protected Disclosures Act 26 of 2000.

65 *Cash Paymaster Services (Pty) Ltd v Browne* [2006] 2 BLLR 131 (LAC).

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67 *CWIU and others v Latex Surgical Products (Pty) Ltd* [2006] 2 BLLR 142 (LAC).

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82 *Protecton (Pty) Ltd v CCMA and others* [2005] 7 BLLR 703 (LC).

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87 Health Professions Act 56 of 1974.

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94 *Coetzer and others v Minister of Safety and Security and another* [2003] 24 ILJ 163 LC.

95 *SA Police Union obo Du Toit and SA Police Service* [2003] 24 ILJ 878 (CCMA).

96 Protected Disclosures Act 26 of 2000.

97 Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000.

98 Labour Relations Act 66 of 1995.

PART E: BUSINESS ORGANISATION

What is the smart way to structure my business?

CHAPTER 25	Sole proprietorship, partnership and joint ventures – *I can choose to run my business on my own, or together with other people*
CHAPTER 26	Close corporations, trusts and co-operatives – *Formal ways to start a business that require registration*
CHAPTER 27	Corporations – *Making the business liable for debts under its own name*

Chapter 25

Sole proprietorship, partnership and joint ventures

'It is not the employer who pays the wages. Employers only handle the money. It is the customer who pays the wages.'

HENRY FORD (1863–1947)
AMERICAN INDUSTRIALIST AND FOUNDER OF THE FORD MOTOR COMPANY

What is covered in this chapter

1 Types of enterprise and choice of business structure
2 Sole proprietorship
3 Partnership
4 Joint ventures
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Sometimes the success or failure of a business depends on the type of structure that has been chosen to set up the business. There are many different issues to consider in deciding how best to set up a business, and these will lead you to select the form of business enterprise that best meets your needs. Each has different advantages and may be governed by different laws.

The choice of business structure that might be most suitable will depend on many issues. These will include:

- Purpose of the business.
- Duration – should the business operate for a limited period of time or indefinitely?
- Cost and method of formation – there are simple or complex procedures.
- Availability and sources of capital at initial and later stages.
- Types of assets to be acquired.
- Whether the business should be bought already established or started from the beginning.
- Powers of control to be vested in the people who own or control the business.
- Selection of key staff.
- Voting powers of the owners.
- Participation in profits and losses.
- Taxation advantages and disadvantages.
- Foreign or local establishment.
- Agency arrangements and liability.
- Transferability of owners' interests.
- Legal standing of the business in its own name.
- Limited liability.
- Requirements of lending institutions.

1 Types of enterprise and choice of business structure

In South Africa, people may trade or go into business in any of the following ways:

- A sole proprietorship.
- A partnership.
- A joint venture.
- A close corporation. (This type of enterprise is to be phased out by 2020.)[1]
- A trading trust.
- A co-operative.
- A company.
- A franchise.

2 Sole proprietorship

The sole proprietorship is the simplest and most common form of business, and is conducted by an individual owner, known as a ‘sole proprietor’ or ‘sole trader’. A sole proprietor conducts business under his or her own name by simply doing business, or he or she can operate under a trade name. A sole proprietorship may have employees and is permitted to carry on most types of businesses.

A sole proprietorship is simple to start and does not have the operating expenses of other legal entities. In deciding whether or not to give a loan to a sole proprietorship, a bank will look at the net worth and individual credit history of only the sole proprietor.

A sole proprietorship has only one owner and, as a result, cannot sell shares or interests in the business.

A sole proprietorship is a financial risk, because the sole proprietor is personally liable for all obligations of the business, including debts and the negligent or willful acts of employees and agents. If the sole proprietor has insufficient insurance to cover the damages, their other assets could be sold. Also, if the business is unsuccessful and is terminated, the sole proprietor will be personally liable for payment of all business debts, such as bank loans and unpaid bills to vendors and service providers. If the personal assets do not satisfy the outstanding business debts, the sole proprietor may be forced into insolvency.

3 Partnership

A ‘partnership’ is a contract (and the legal relationship created by that contract) between at least two persons, in which they all agree to contribute money, labour, or skill in a common stock, and to carry on business with the object of making a profit for their joint benefit.[2]

3.1 Formalities of partnership

No formalities are required for the formation of a valid partnership. A valid partnership can be created verbally or by a written agreement.

3.2 Essential elements of partnership

There are five essential elements that must be established before there is a valid partnership.[3]

3.2.1 Contract of partnership

The contract must be valid according to the ordinary rules of contract. No formalities are required, although it is preferable that the agreement be put in writing. A valid partnership may be formed by conduct.[4]

3.2.2 Two or more persons

Normally, the term ‘partnership’ applies to associations of natural persons in which each partner is jointly and severally liable for the debts of the entire partnership. Juristic persons normally form ‘joint ventures’ in which each party is normally only liable jointly for debts, in other words, each JV party is liable for only their own debts and not for the debts of the other JV parties as well.

In some cases it is possible for juristic persons to form partnerships, though it is highly unlikely that a juristic person would want to assume joint and several liability with others. Joint ventures are dealt with later in this chapter.

In this text, it will be assumed that only natural persons will be partners or comprise a partnership.

3.2.3 Contribution to a common stock

The contribution by each partner may be in the form of labour, skill, or money. The contributions make up the common fund jointly owned by the partners.[5]

A contributor is not a creditor of the partnership. This would reduce a partner's contribution to a simple loan. Partners, however, may also lend money to the partnership. While the partnership agreement exists, the partnership property is owned in common by the partners in undivided shares. An individual partner may not deal with the property except to the extent that he or she has authority from the partnership to do so.

On termination of the partnership, the remaining partnership property generally is returned to the individual partners in the proportions in which it was contributed.

3.2.4 Carry on business with the intention of making a profit

A ‘business’ is anything that occupies the time, attention, and labour of a person for the purposes of profit. As a general rule, only one or two isolated transactions cannot be described as the carrying on of a business.

There must be a common interest in carrying on the business. If the business remains vested in one of the parties, and the other simply manages and controls the business, there is no partnership. Each partner is the agent of the other to carry on the business and to incur liability on behalf of all the partners. This implied authority extends only to transactions that fall within the scope of the partnership business.

The business must be carried on with the object of making a profit. An association of persons that is formed for a purpose other than making a profit is not a partnership and those members are not partners.[6]

3.2.5 Joint benefit

Profits and losses must be shared between the partners in the proportions expressly agreed upon. If there is no agreement, profits are shared in the same proportion as the partners' contributions to the common stock.[7]

3.3 Partnership compared to sole proprietorship

This is illustrated in Table 25.1.

Table 25.1 *Sole proprietorship and partnership compared*

	Sole proprietorship	**Partnership**
Separate legal identity	No. Private individual.	No. Private individuals or entities.
Ownership of property	The trader.	The partners.
Can creditors attach private goods?	Yes.	Yes, but partnership assets must be exhausted first.
Liability for debts	The sole trader personally.	The partners personally.
Extent of the liability	Unlimited.	Unlimited, except for a commanditarian partnership.
Capacity to contract	The sole trader.	Usually any one of the partners.
Minimum number of participants	One.	Two.
Maximum number of participants	One.	Unlimited.
Liability for tax	Sole trader.	Partners as individuals.
On death of a participant	Business terminates.	Partnership ceases, but may be reinstated.

3.4 Nature of partnership

A partnership has no separate legal identity from that of its members; it is simply a group of persons acting jointly. In terms of the Insolvency Act[8] if the court sequestrates the estate of a partnership it must simultaneously sequestrate the estate of every member of that partnership. Therefore, unlike business entities with limited liability such as companies, in

partnerships the partners are individually and personally liable for the debts of the partnership.

In terms of rule 54 of the magistrates' courts rules and rule 14 of the High Court rules, a partnership may sue or be sued in its own name. This is for convenience only. Unlike a company, a partnership is not a legal person with a distinct legal personality.[9]

South African law recognises two types of partnerships:[10]

3.4.1 Universal partnership

This form of partnership is also known as an ‘ordinary partnership’. The contracting parties intend that everything they acquire during the partnership, from all kinds of commercial ventures, shall be partnership property. The agreement to form this type of partnership may be express or tacit.[11] In an ordinary partnership each partner is jointly and severally liable for the debts of the partnership.

To hold a partnership liable, a third party must prove three elements to the court:

- **The partnership existed at the time the debt was incurred**: If the partnership merely was held out to exist at that time, the doctrine of estoppel applies. This means that the partnership is prevented from denying its own existence, even if it was not yet formed.
- **The contracting party had authority to bind the partnership**: Authority may be express or implied.
- **The contracting party contracted on behalf of the partnership**: However, where the party contracts in his or her own name alone, that person is singly liable, even if the partnership derived some benefit from the contract.

3.4.2 Extraordinary partnership

In this type of partnership the liability of certain partners is expressly limited.

There are three types of extraordinary partnerships.[12]

3.4.2.1 Anonymous partnerships

This is a form of partnership by which two or more persons agree to share in some business that will be conducted by one of them, solely in that one person's name. The name of the anonymous partner is not disclosed to the public, and, as a result, his or her credit is not relied upon by third parties. He or she may not actively participate in the business of the partnership. On insolvency of the partnership, the anonymous partner is entitled to be paid out only after all creditors of the partnership have been paid in full.

The anonymous partner is not liable to third parties for the debts of the partnership, but only to the disclosed partners. The undisclosed partner is not liable for any fixed sum, but to the full extent of his or her share in the partnership's deficiency, that is, for his or her proportionate share of the debts.[13]

3.4.2.2 Commanditarian partnerships

This is a partnership in which business is to be carried on in the name of one partner only, but to which the undisclosed partner contributes a specific sum of money. The partners agree that the undisclosed partner is to have a share of the profits, if any, and to bear losses, if any, but in no case is the liability of the undisclosed partner to exceed his or her specific contribution.

The commanditarian partner may not actively participate in the business of the partnership. He or she is not liable to third parties; only to the disclosed partner. The commanditarian partner is liable only to the extent of his or her contributions. If the partnership becomes insolvent, he or she will be paid only after all creditors have been paid.

An anonymous partner and a commanditarian partner are directly liable to third parties for partnership debts only if they are publicly held out as partners. The mere fact that outsiders become aware or informed of the nature and terms of the partnership does not render that partner liable to partnership creditors. That partner only loses this protection if he or she has acted as an ordinary partner, or held himself or herself out to be an ordinary partner.

A comparison between anonymous and commanditarian partnerships is illustrated in Table 25.2.

3.4.2.3 Partnerships under the Special Partnerships Limited Liability Acts

In the Cape (under its 1861 Special Partnerships' Limited Liability Act)[14] and in Natal (under its 1864 Special Partnerships' Limited Liability Act),[15] special laws were passed for the registration of partnerships in which the liability of certain members was limited. The repeal of these laws under the

1976 Pre-Union Statute Law Revision Act[16] has not affected the protections duly taken up by special partners while those laws were in operation.

Table 25.2 *Anonymous and commanditarian partnerships*

	Anonymous partnerships	**Commanditarian partnerships**
Joint and several liability	Not all partners are jointly and severally liable to third parties for the partnership debt.	Not all partners are jointly and severally liable to third parties for the partnership debt.
Existence of partner known to the public or not	Not known to the public.	Not known to the public.
Number of partners conducting business	Partnership business conducted by only one partner and in his or her name.	Partnership business conducted by only one partner and in his or her name.
Liability on identity being revealed to the public	Liable to third parties for all partnership debts as if he or she were an ordinary partner.	Liable to third parties for all partnership debts is limited to the extent of his or her capital contribution.
Extent of liability	Liable to co-partners for his or her share of the partnership debts.	If the partner reveals himself or herself to the public, he or she then becomes liable to third parties for partnership debts and loses the protection of limited liability.

3.5 Rights and duties of partners[17]

3.5.1 To contribute

The contribution can be in money or in kind. Property also may be contributed:

- **Movables**: Constructive delivery of movables occurs immediately at the conclusion of the partnership agreement.[18]
- **Immovables or incorporeals**: Any partner may bring a court action against a partner who fails to deliver what he or she has agreed to contribute. The action is available to each partner, and his or her heirs,

against the co-partners and their heirs, for the performance of those obligations that result from the nature of the transaction or the special agreements in the contract. Bringing the action does not necessarily dissolve the partnership. If no dissolution is asked for, or if it is not necessary to dissolve the partnership to ascertain damages or profits or losses, the court may allow the partnership to continue if this is in the interests of the parties.

3.5.2 To use the partnership property in a proper manner

Partnership property may be used only for the partnership. All profits resulting from partnership property belong to the partnership. All partners have the right to use the partnership property, but only with the consent of the other partners. The partnership property may only be alienated with the consent of all the other partners.

3.5.3 To carry on business

A partner contracts as if he or she were both principal and agent in the same transaction. A partner is required to perform partnership business honestly and carefully, in accordance with the authority explicitly or implicitly granted, and to account to the remaining partners. A partner is entitled to reimbursement for expenses and indemnity for losses. Instead of remuneration, he or she is entitled simply to a share in the profits. The failure of a partner to carry on the business as agreed renders him or her liable for breach of contract.[19]

3.5.4 To show good faith

A partnership is regarded as a contract of ‘utmost good faith’ or *uberrimae fides*.[20] A partner may not make secret profits from partnership transactions or make use of partnership property. He or she may not acquire a benefit for himself or herself that falls within the scope of the partnership business if it is his or her duty to acquire the benefit for the partnership. All those benefits must be shared with, and accounted to, other partners.

***Wegner v Surgeson*[21]**

One partner, without the knowledge of the other partner, applied in his own name for the renewal of a lease. The lease was in fact renewed after the dissolution of the partnership.

The court held that the lease was a partnership asset.

Personal interests may not conflict with those of the partnership, for example a partner may not open his or her own business to compete with the partnership.[22]

Each partner has a duty to account to the partnership for everything he or she has obtained as a partner and within the scope of the partnership business.[23]

De Jager v Olifants Tin 'B' Syndicate[24]

A partnership was formed to prospect for mineral rights to tin. One of the partners, who was sent to a particular farm to investigate prospects for tin, found good prospects on a neighbouring farm. He acquired the rights for himself, without telling his partners.

The court held that the relationship between partners is one of trust and that, since the rights fell within the scope of partnership business, the partner had acquired a benefit for which he had to account to the partnership.

3.5.5 To share in the profits and losses

A partner may be compelled to share profits with the other partners by them applying to court.[25] In the absence of an agreement to the contrary, partners share profits in proportion to their respective contributions. Losses are shared in the same proportion as profits.[26]

3.5.6 To ensure that proper books are kept and to allow co-partners free access to them

For convenience, accounts only need to be made on termination, or at intervals according to trade usage. Partners dissatisfied with the correctness of accounts may apply for a review by the court. Courts will be loathe to do so unless there is an application for dissolution of the partnership as well.[27]

3.6 Remedies for breach of duty of partners

Remedies may include one or more or all of the following:

- Specific performance.
- Damages.
- Interdict.
- Dissolution of the partnership.

No partner may sue another partner during the currency of the partnership for money or transfer of property allegedly owed to him or her. These actions may only be brought after the dissolution of the partnership.[28]

3.7 Termination of partnership

3.7.1 Ways a partnership may be terminated[29]

- **By agreement between the partners, either explicit or implicit**: A partnership may dissolve by express agreement between the partners, or may endure for the duration of time specified in the initial partnership agreement. Implied agreements to terminate occur on the completion of the object of the partnership. Any change of members of the partnership terminates the agreement. The departure or introduction of a new partner ends the original partnership and a new partnership is constituted.[30]
- **By the unilateral action of one partner, with or without a court order**: If a definite time for the partnership has not been fixed (that is, it is a partnership at will), any partner may dissolve the partnership at his or her own discretion by the unilateral act of giving a notice of renunciation. A partnership at will is an agreement to act as partners until one of them no longer desires to do so.[31]

Rules relating to a notice to terminate a partnership at will include the following:

- Notice to terminate the partnership must not be unreasonable or fraudulent.
- Notice must be given at a reasonable time without the intention of overreaching the other partners, that is, getting the better of them.
- Notice must not be given for the intention of obtaining benefits for the renouncing partner at the expense of remaining partners.[32]

If a definite time for the partnership has been fixed, the partnership may only be unilaterally dissolved by one partner by an order of the court. The court will examine the destruction of mutual cooperation and confidence between partners and the lack of any reasonable expectation of profit. Any good cause for this destruction is sufficient, provided it was not caused by the applicant, for example adultery.[33]

Curtis and Curtis v Beart [34]

One of the partners in a shop was guilty of mismanagement and neglect, and had refused to stop drinking with customers. The business was running at a loss.

The court held that the other partners were entitled to an order for the dissolution of the partnership on the grounds that the one partner's misconduct had destroyed the other partners' confidence and made cooperation impossible, and also that there was no reasonable expectation that any profit would be made.

- **On the insolvency of the partnership, or of any one partner**: The partnership will be terminated automatically on the sequestration of the estate of any partner or of the partnership itself. Any partner whose personal estate has not been sequestrated on the insolvency of the partnership (for example if that partner has given security in terms of the Insolvency Act,[35] or if that partner is a duly incorporated company), may be personally proceeded against by any creditor of the partnership.
- **On the death of a partner**: The partners may agree explicitly that the partnership will not be dissolved on the death of one of them, but will continue for the full term.[36]
- **By the object of the partnership becoming illegal or impossible**: The partnership is terminated on the date on which the object becomes illegal or impossible.[37]
- **Change of membership**: When a new partner is admitted, or when a partner leaves, the partnership is automatically terminated, and a new partnership is created.[38]
- **Mental illness:** The court may dissolve a partnership in which one of the members has been declared incapable in terms of the Mental Health Act.[39]
- **Notice of dissolution**: In the absence of a specific clause in the partnership agreement, the notice of dissolution must be given within a reasonable time (taking into consideration the interests of the

partnership), and must be given in good faith for a just cause. If either of these requirements is not met, the partner giving the notice may be liable for damages.

- **The court may order dissolution for lawful cause on any of the following grounds**:
  - Breach of an explicit or implicit essential term of the partnership agreement, for example, neglect or failure to perform.[40]
  - Where the conduct of a partner causes loss of confidence in him or her, or any other partner or partners.[41]

3.7.2 Consequences of termination of partnership

On termination of the partnership for any reason, the relationship between the partners changes, as well as the relationship between the partners and third parties.[42]

Termination will affect the partners as follows:

- **Joint and several liability**: Individual partners cannot be personally sued on a partnership obligation while the partnership exists. The partnership must be sued as a whole. After termination, any creditor can sue any ex-partners as individuals, both jointly and severally.[43]

> ***Lee en 'n ander v Maraisdrif (Edms) Bpk*** [44]
>
> An ordinary partnership of three sisters ran a farming operation. The partnership terminated by agreement; however, the operation owed money. One of the sisters paid one third of the amount; however, the other two refused on the basis that the partnership continued to be in existence until it was liquidated formally, and only then would any outstanding debts be paid from any remaining proceeds.
>
> The court held that a member of a partnership is liable for the full amount of the partnership debt as soon as the partnership is dissolved, even although the liquidation of the partnership has not been completed.

- **Termination of the partners' mandate**: After termination of the partnership, ex-partners lose their implicit authority to bind the other partners or the partnership.

  The doctrine of estoppel may operate against ex-partners. As a general rule, ex-partners are prevented from denying to clients of the partnership that one of them had authority to bind them all, if the client

has been dealing with that ex-partner after the dissolution of the partnership and the client was unaware of the dissolution. Estoppel only ceases if third parties were given notice of the termination of the partnership.[45]

- **Accounting between the partners**: On termination, each partner may demand an accounting from co-partners and has the right to inspect and examine partnership books. Only under special circumstances will courts order an accounting of partnership dealings while the partnership is in existence.

Robson v Theron [46]

Two veterinary surgeons verbally agreed to combine both their individual practices into a single partnership in Gauteng. They were to have equal shares in the partnership property, to share the net profits of the partnership equally and to bear the losses of the partnership equally. They contributed the goodwill of their separate practices as opening goodwill of the partnership. They continued to use the offices of their previous practices as consulting rooms. The partnership was terminated by agreement almost ten years later. One partner wanted to leave to be closer to an ill parent in Natal, and the other would carry on business as a vet using the previous partnership property. They disagreed, however, that any goodwill had to be paid.

The court held that where two partners dissolve a partnership by agreement and one partner retains the goodwill of the partnership for his own use and benefit, the retiring partner is entitled under the common law to payment of his half share of the goodwill from the continuing partner. Where it is impossible to divide the goodwill between the parties or to cause it to be auctioned and to have the proceeds divided between the parties, the court will place a valuation on the goodwill at the date of dissolution, and order payment of half that amount to the retiring partner.

4 Joint ventures

4.1 Defined

A ‘joint venture’ is an association of persons, natural or juristic, who agree to engage in a common undertaking by combining selected property and expertise resources, without forming a partnership or corporation.

The parties have a joint proprietary interest, a joint right of control, and a sharing of profits and losses.[47]

The agreement also provides for a community of interest among the joint venturers, each of which is both principal and agent in respect of the others within the scope of the joint venture. Assets are usually owned by the participants individually, or else ownership is joint, with each participant's share expressed as a percentage. The parties have a right to receive their share of income separately.[48]

The term ‘joint venture’ is usually used where the parties concerned intend to pursue a single venture only, for example, in the mining industry joint ventures are often formed for the purpose of prospecting a certain area. Once a viable deposit is found the exploitation of the minerals is thereafter carried out by a company in which the joint venture members become shareholders. International joint ventures are common in the fields of research and development, national resource exploration and exploitation, engineering and construction, production/manufacturing, buying and selling and services.

Joint venture arrangements are frequently used in mining syndicates; property developments; manufacturing arrangements; publishing arrangements; entertainment agreements; industrial research and development agreements; and share-farming arrangements.

4.2 Benefits of joint ventures

Typical benefits of choosing a joint venture as the entity through which to conduct business are as follows:[49]

- Cross ethnic, business and cultural boundaries to take advantage of the local party's domestic knowledge and skill.
- Share risk.
- Inherently flexible mechanisms.
- May create competitive advantages in markets.

4.3 Formalities

Normally, there are no formalities required for the formation of a joint venture. However, it would be considered most unwise to operate without a clearly defined set of terms and conditions governing matters such as the absence of agency, rights of creditors, and proportionate share of the joint venture participants.[50]

A joint venture agreement may be used to ensure that control over the joint venture is vested in a management committee representing the joint venture participants, with voting rights in proportion to their respective contributions. A manager might also be agreed upon, whose rights and responsibilities might include the management of any operating funds, control of finances and bank accounts, dealing with property held by the joint venture participants, and entering into third party contracts, including contracts of employment.

A joint venture is not a separate legal entity. Joint venture participants are each liable for their respective proportions of the debts of the joint venture, unless they have made an agreement to the contrary. Whether the relationship between joint venture participants is a fiduciary one will depend on the form that the particular joint venture takes, and the content of the obligations the parties have undertaken.[51]

Typical factors to consider when drawing up the agreement between joint venture parties are as follows:[52]

- Regulation of the working relationship between joint venture parties.
- Funding techniques and forms of contribution by each party.
- Limiting liability of participants to the assets contributed to the common activity.
- Forms of security to be provided between the parties to one another, and jointly to clients.

- Division of management and control in relation to percentage interest of the parties in the joint venture.
- Protection for intellectual property.
- Tax considerations, especially if different jurisdictions apply to each party, and if one regime taxes with reference to residence and the other to source of income. Consideration should also be given to the best means to utilise losses and shelter profits.
- Mechanisms for dispute resolution, preferably arbitration to preserve the joint venture relationship.
- Industrial relations and employment-law considerations.
- Restraints of trade.
- Consequences of termination of joint venture, especially in respect of warranties and long-term obligations to the client.

4.4 Joint venture and partnership compared

A distinction is often drawn between the term ‘partnership’ and the term ‘joint venture’.[53]

Differences between a joint venture and a partnership:

- Juristic persons may not form a partnership.
- The liability of joint venture participants is generally individual, not joint.
- It is possible for joint venture participants to agree that they may not bind one another as agents.
- Joint venture participants receive their respective shares of the profits separately.

Advantages of joint ventures over partnerships:

- Each joint venture participant is generally not liable for the acts or omissions of other participants.
- The taxation system allows each joint venture participant to account for its own share of assets and expenditure.
- Each joint venture participant may dispose of its share of the product.
- The rights of a joint venture participant may generally be transferred or assigned without the consent of the other participants being required.

- Joint venture participants may be able to compete with one another in certain circumstances, outside of the joint venture.
- Tax advantages may be available for foreign corporations that are joint venture participants that would not be available to partners.

Bester v Van Niekerk [54]

Bester was a farmer who discussed buying cattle from Van Niekerk, but the deal was too much for him alone. Bester then introduced another man called Carr to Van Niekerk. Bester and Carr inspected the cattle and after discussion a deal was made to buy 182 head, with the intention of selling them at a profit. Both Bester and Carr were present when the cattle were delivered, and all the cattle were sold by auction in Bester's name. All payments were made into Bester's account, and he then paid Carr. Van Niekerk went to see Bester three times to get paid what he was owed; at no time did Bester deny being liable for payment. When Bester was sued by Van Niekerk for the full price he claimed that he and Carr had contracted as a joint venture. He said that he had simply been helpful in assisting Carr who should bear all the liability because Carr was the sole purchaser.

The court held that a joint venture in respect of a single transaction can be a partnership provided that three essential elements are present: First, that each of the partners brings something into the partnership, or binds himself to bring something into it, whether it be money, or his labour or skill. Secondly, that the business should be carried on for the joint benefit of both parties. Thirdly, that the object should be to make profit. Since all three essentials were present, both parties had been in a partnership and both were jointly and severally liable.

PRACTICALLY SPEAKING

Tips on how to work with a business partner [55]

There are so many different skills that have to be mastered when you start and run a business, that it can be quite overwhelming.

You will find your skill set stretched virtually every day, especially in the first few years. One moment you will be mastering Excel to do some cash flow predictions; next you may find your creative talents being tested while you design a flyer; an hour later you may be sat in front of a potential buyer pitching for business.

It is not surprising that some people find it tough to cope with. Many people start their own business because they are good at delivering their service or making their product. Getting out there and selling it is a whole different ball game!

Teaming up with a business partner can bring more success. If you are worried about it, maybe you should consider getting together with a business partner. If you can make something and someone else can sell it, then working together could make each of you more money than working separately.

While this makes perfect sense on paper, the realities of sharing a business with someone else can be challenging. Working closely with someone in business is pretty much like being married, with all the highs and lows (but without the sex and housework!) You need to be able to trust each other and communicate openly, not just in bad times but the good times too.

If there is any resentment between you – even just a tiny scrap of annoyance about workload – this will cause problems. If you think you are doing 75% of the work, you will be furious at handing over 50% of the profit. And if it goes wrong, the 'divorce' will consume your time and energy and cause untold damage to your business. When partnerships go bad, years of hard work go down the drain.

Here are some things to think about before you enter into a partnership:

- **Is getting a business partner the right thing to do?** If you are a control freak you will probably not work successfully on an equal basis with someone else. Be clear about your reasons for working with a partner. If you need someone just for money, that is not a solid base for a partnership.
- **Be objective**: The worst kind of partner is your best friend 'just because you are friends', or worse, someone you feel sorry for because they are down on their luck. You would not marry someone on this basis. You need to think about the person you are considering with your brain, not your heart.
- **Ensure you and your business partner have different skill sets**: Getting a clone of yourself is pointless and will leave the business with a gaping hole. Make a list of the key skills your business needs to have to succeed, tick off the skills that you already possess or can easily learn, and then find a business partner who has the ability to tackle the skills you do not have. You will not find someone who is a perfect fit, but you can get close.
- **Take your time**: Do not rush into a partnership, even if you urgently need help. In fact if you are in urgent need of a partner, now is not the time to go looking for one. Just as drunken Las Vegas weddings can be regretted, so can shotgun partnerships.
- **Make it an equal partnership**: Split the work 50:50 from day one, and ensure you each have an equal financial investment.
- **Protect yourselves legally**: Every business partnership must have a solid legal basis. Use an attorney to help you decide in advance how you will work together, own the business, and what you will do if it goes wrong. Do not be tempted to skip this, or you may well regret it.
- **Make rules and stick to them**: If you know what responsibilities each of you has, your business will thrive with two of you. But make sure of it by giving your partnership a formal review every quarter (your business will certainly benefit from this). Do it off-site and away from work, perhaps over a meal. Most importantly, do not forget to enjoy the spoils of your hard work together.

THIS CHAPTER IN ESSENCE

1. The sole proprietorship is the simplest and most common form of business, and is conducted by an individual owner, known as a ‘sole proprietor’ or ‘sole trader’. A sole proprietor conducts business under his or her own name by simply doing business, or he or she can operate under a trade name.
2. A ‘partnership’ is a contract (and the legal relationship created by that contract) between at least two persons, in which they all agree to contribute money, labour, or skill in a common stock, and to carry on business with the object of making a profit for their joint benefit. Normally, the term ‘partnership’ applies to associations of natural persons in which each partner is jointly and severally liable for the debts of the entire partnership.
3. South African law recognises two types of partnerships: universal partnerships, and extraordinary partnership. There are three categories of extraordinary partnership: anonymous, commanditarian, and partnerships under the Special Partnerships Limited Liability Acts.
4. Rights and duties of partners are: to contribute; use the partnership property in a proper manner; carry on business; show good faith; share in the profits and losses; and to ensure that proper books are kept and to allow co-partners free access to them.
5. A joint venture is an association of persons, natural or juristic, who agree to engage in a common undertaking by combining selected property and expertise resources, without forming a partnership or corporation. There may be tax and liability advantages for forming a joint venture instead of a partnership.

QUESTIONS

Short questions (1–5 marks)

1. Define what is meant by a sole proprietorship.
2. Define what is meant by a partnership.
3. List four types of partnership that may exist.

4. List four rights and duties of partners.
5. List four remedies available to partners for the breach of a duty by another partner.
6. List nine ways in which a partnership can be terminated.
7. Name four consequences of the termination of a partnership.
8. Define a joint venture.
9. List the differences between a joint venture and a partnership.

Paragraph questions (5 marks)

1. Discuss the essential elements of a valid partnership.
2. Fully discuss the various types of ordinary partnership that may exist.
3. Fully discuss the various types of extraordinary partnership that may exist.
4. How does a partnership terminate and what are the consequences?

Essay questions (10 marks)

1. Discuss the factors a businessperson would consider in deciding whether to enter into a commercial arrangement by way of partnership or joint venture.

Problem questions (20 marks)

1. Morgan decides to go into partnership with his brother, Stanley, to sell goods in a general store near a squatter camp. In terms of the arrangement, Morgan will contribute R5 000 and Stanley will run the shop. After a while Morgan notices that Stanley is taking some of the goods home with him for personal use. They fight, and Morgan tells Stanley that he is going to a lawyer. Advise Morgan.
2. Jacob is a traditional man who over the years takes a total of 20 wives in various traditional ceremonies. All of them live together in the same big house. None of the marriages was performed by a registered marriage officer. Wife number 20 is a modern woman, who does not like the way he treats women in general, and decides to leave him. She claims that she is entitled to

1/20th of his assets because her traditional marriage was in fact a partnership. Advise her.

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1 Companies Act 71 of 2008.

2 *Joubert v Tarry and Company* 1915 TPD 277; *Bester v Van Niekerk* 1960 (2) SA 779 (A); Fouché, 256; Gibson, 246; Havenga et al., 154; Sharrock, 457.

3 Fouché, 258–260; Gibson, 246–252; Havenga et al., 154–155; Sharrock, 457–462.

4 *Poppe Rossouw and Company v Kitching* (1886) 6 SC 307.

5 *Angehrn and Piel v Friedman* 1903 TH 277.

6 *Novick v Benjamin* 1972 (2) SA 842 (A).

7 *Estate Davidson v Auret* (1905) 22 SC 10; *Langermann v Carper* 1905 TH 251; *Feitelberg v Kaplan* 1913 WLD 48.

8 Insolvency Act 24 of 1936.

9 *Parker v Rand Motor Transport Company* 1930 AD 353; Gibson, 253–258.

10 Kahn, *Contract and Mercantile Law through the Cases* Vol 2, 423.

11 *Isaacs v Isaacs* 1949 (1) SA 952 (C); *Annabhay v Ramlall* 1960 (3) SA 802 (D).

12 Fouché, 260–261; Gibson, 258–260; Sharrock, 462.

13 *Sacca Ltd v Olivier* 1954 (3) SA 136 (T); *Eaton and Louw v Arcade Properties (Pty) Ltd* 1961 (4) SA 233 (T).

14 Special Partnerships' Limited Liability Act 1861 (Act 24 of 1861 of the Cape of Good Hope).

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20 *Wegner v Surgeson* 1910 TPD 571.

21 Ibid.

22 *De Jager v Olifants Tin ‘B’ Syndicate* 1912 AD 505.

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26 *Fink v Fink* 1945 WLD 226.

27 *Romera v Buch* 1917 TPD 266; *Tshabalala v Tshabalala* 1921 AD 311; *Joubert v Jacob* 1962 (1) SA 125 (T).

28 *Harvey v De Jongh* 1946 TPD 185.

29 Fouché, 264–265; Gibson, 260–266; Havenga et al., 157–158; Sharrock, 468–470.

30 *Executors of Paterson v Webster Steel and Company* (1881) 1 SC 350; *Standard Bank v Wentzel and Lombard* 1904 TS at 835.

31 *Wegner v Surgeson* 1910 TPD 571 at 577.

32 *Parr v Crosbie* (1886) 5 EDC 197.

33 *Curtis and Curtis v Beart* 1909 TH 141; *Salter v Haskins* 1914 TPD 264; *Purdon v Muller* 1960 (2) SA 785 (E).

34 *Curtis and Curtis v Beart* 1909 TH 141.

35 Insolvency Act 24 of 1936.

36 *Torbet v Executors of Attwell* 1879 Buch 195.

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38 *Torbet v Executors of Attwell* 1879 Buch 195.

39 Mental Health Act 18 of 1973.

40 *Strachan v Prinsloo* 1925 TPD 709.

41 *Armstrong v Wallwork* 1913 CPD 978; *Purdon v Muller* 1961 (2) SA 211 (A).

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43 *Pienaar v Suttner Brothers and Hirschfeld* 1914 EDL 419.

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Chapter 26

Close corporations, trusts and co-operatives

'There is only one boss. The customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else.'

SAM WALTON (1918–1992)
AMERICAN BUSINESSPERSON AND ENTREPRENEUR, FOUNDER OF WALMART

What is covered in this chapter

1 Close corporations

2 Trading trusts

3 Co-operatives

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

Sometimes the success or failure of a business depends on the type of structure that has been chosen to set up the business. There are many different issues to consider in deciding how best to set up a business, and these will lead you to select which form of business enterprise best meets your needs. Each has different advantages and may be governed by different laws.

1 Close corporations

A close corporation is a juristic person endowed by the Close Corporations Act[1] with legal personality and has powers similar to those of a company.

A close corporation has its own legal capacity and enjoys 'perpetual succession'.[2] This means it can carry on in existence forever, until it is liquidated and deregistered. A close corporation has 'members', not 'shareholders' as in a company. Only natural persons may be members and hold an interest in a close corporation. The interest is expressed as a percentage. A maximum of ten natural persons may be members.[3]

The Companies Act[4] does not allow for any new close corporations to be registered after 1 April 2010; however, those in existence until that date will continue to operate for a ten-year period, during which all close corporations will be converted into companies.

Until 2020, the Close Corporations Act[5] will continue to apply to all close corporations that remain in existence.

1.1 Formalities

For close corporations formed before 31 March 2010, there were few formalities required for registration. Incorporation required the registration of a document called a 'founding statement' with the Registrar of Close Corporations. This document could be bought from a stationery shop.

The document had to contain details of the following:

- The name of the close corporation, followed by the upper case letters ‘CC’.
- The main business.
- The postal and business addresses.
- The names, identity numbers, and addresses of each member.
- The percentage of each member's share.
- The particulars of the contribution of each member.
- The name and details of the accounting officer. He or she does not need to be a chartered accountant; several other qualifications are acceptable.
- The date of the financial year-end.

Although the founding statement is a public document, the doctrine of constructive notice does not apply to it.[6] Members stand in a ‘fiduciary relationship’ towards the close corporation. This means that each member must act for the benefit of each of the others, because they have had placed in them the utmost trust and confidence to manage and protect property or money.

Members are in the same position as directors towards a company. Every member is entitled to participate in the carrying on of business and management.

Rather than subscribe for shares, members make a contribution to the close corporation, and receive an interest in it expressed as a percentage. The close corporation may give financial assistance to a member for the purchase of that member's interest, or may even buy the interest of a member for the close corporation itself.

1.2 Authority and liability

It is possible for one member of a close corporation to bind the close corporation to an agreement even though other members did not know about the agreement, or grant any authority on the first member to conclude the agreement. This is because every member of a close corporation is an agent of the close corporation for all purposes, including entering into contracts on behalf of the close corporation.[7]

Hanekom v Builders Market Klerksdorp (Pty) Ltd and others[8]

The sole member of a close corporation signed a deed of suretyship on behalf of the close corporation. After the liquidation of the close corporation he applied for an order declaring the deed of suretyship invalid as there had been no prior written approval by all the members of the close corporation, as required by section 52(2) of the Close Corporations Act.[9]

The court held that the purpose of the section was the protection of members of the particular corporation. There could be no problem in interpreting the sole member's signing of the suretyship on behalf of the close corporation as written consent to the giving of security.

A member is an agent even if no authority, express or implied, has been granted to him or her. The close corporation is bound unless the third party with whom the member had contracted knew or ought reasonably to have known of the lack of authority.

In some cases, members can be held personally liable for losses incurred by a close corporation:

- Where a member breaches a fiduciary duty.
- Where a member fails to act with the required degree of care and skill.

Members, in some cases, may be held personally liable for the debts of a close corporation:

- If the abbreviation ‘CC’ is omitted from the close corporation's name on any contract, a person who suffers loss as a result of the omission and who is not aware that he or she was dealing with a close corporation, may hold the members jointly and severally liable for debts resulting from the transaction.
- If a member fails to pay his or her contribution in cash or in kind.
- If the number of members exceeds ten persons.
- If persons other than natural persons become members.
- Where a member is knowingly a party to the carrying on of business in a reckless, grossly negligent, or fraudulent manner.

1.3 Close corporation compared to a company[10]

Table 26.1 *Differences between a close corporation and a company*

	Close corporation	**Company**
Legal personality	Juristic person with perpetual succession.	Juristic person with perpetual succession.
Limited liability	Limited liability.	Limited liability.
Number of members	Maximum of ten shareholders.	No maximum number of shareholders.
Ownership	Members hold a member's interest.	Shareholders hold securities called ‘shares’.
Limitations on ownership	Juristic person cannot hold a member's interest. CC can purchase a member's interest.	Companies can hold shares. Can acquire their own shares under certain circumstances.
Composition	Comprises of members.	Shareholders appoint a board of directors.
Documents governing activities	Founding Statement.	Memorandum of Incorporation.
Annual financial statements	No need to be audited.	Must be audited.
Financing	Member's contributions.	Share capital.
Limitations on financing	No limitations on a CC to provide financial assistance for the acquisition of a member's interest.	Certain limitations on a company to provide financial assistance for the acquisition of its own shares.
Financial controls	Has an accounting officer.	Has an auditor.
Formal decision making	Annual general meeting is not required.	An annual general meeting must be held.
Proof of registration	Certificate of Incorporation.	Registration certificate.
Management	Members are responsible for the day-to-day management of the CC.	Directors are responsible for the day-to-day management of the company.
Records of ownership	No register of members must be kept.	Register of shareholders must be kept.

1.4 Annual financial statements

A close corporation's annual financial statements must be prepared within nine months of its year-end. The annual financial statements must be approved and signed by or on behalf of members holding at least 51 per cent of the members' interest in the close corporation and must comprise:

- Balance sheet and notes.
- Income statement.
- Members' net investment statement.

The financial statements must fairly represent the state of affairs and the business of the close corporation in conformity with Generally Accepted Accounting Practice (GAAP).[11]

1.5 Annual audit requirement

Close corporations are not required to have to have a compulsory audit every year. However, the corporation must appoint an independent accounting officer to prepare the financial statements and who must be a member of one of the recognised professional accounting bodies.

1.6 The end of close corporations

The Companies Act[12] does not allow new close corporations to be registered, and contemplates existing close corporations being phased out and converted into companies by 2020.[13]

2 Trading trusts

2.1 Legal and equitable interests

The concept of the trust was developed by English law in the Middle Ages, through courts of equity. These courts developed the concept of an ‘equitable interest’ in property, in contrast to a ‘legal interest’ that was already recognised by the common law. At its simplest, it means that a legal owner of land might have to acknowledge the rights of others who have other interests in that land, known as equitable interests. These other interests might fall short of the legal right of ownership, and may consist, for example, of the rights of a mortgagee, a spouse in a matrimonial home, or of a beneficiary in a trust.

Our courts have long held that the English law of trusts, based on the law of equity, does not apply in South Africa.[14] South African trust law is based on the law of contract, and not the law of equity.

Our law takes a strictly technical approach to trusts. Our courts have allowed actions that are potentially prejudicial to beneficiaries, as long as these actions are taken in accordance with the trust deed. For example, the settlor and the trustee can cancel or amend the contract entered into between them before the third party has accepted the benefits conferred on him under the settlement. Trust deeds can be amended by agreement between the donor and the trustees.[15] It is not up to the trustee in his or her fiduciary position to agree to a revocation or amendment of the trust agreement only if he or she considers it to be in the interests of the beneficiaries or potential beneficiaries.

One area of concern is the ‘sham’ trust. This occurs when either the settlor or one of the trustees has too much control over trust assets and trust decisions. This results in the trustees acting as nominees. They do not act as independent trustees, and do not exercise independent judgement. Courts have held that such a trust is a sham, and have refused to recognise the trust, with the result that the trust assets are open to attack by creditors and spouses.[16]

Badenhorst v Badenhorst[17]

A wife divorcing her husband claimed half of the value of his estate, including the assets of a trust that they had both created during the marriage. She argued that the trust was not managed separately from the husband's affairs, and that both parties had contributed income and talent in order to acquire trust assets.

The court held that it was incorrect to refer to a trust as a separate legal entity. The mere fact that the assets of a trust vested in the trustees and did not form part of the husband's estate did not necessarily exclude them from consideration when determining what must be taken into account in making a redistribution order. To succeed in a claim that trust assets be included in the estate of one of the parties to a marriage there had to be evidence that the person controlled the trust, and, but for the trust, he would have acquired and owned the assets in his own name.

The court stated that it was not interested solely in the form of the trust, but also in how the trust was actually run in practice. To determine whether one party had actual control it was necessary to consider the evidence of how the affairs of the trust were conducted. In this case the extent of the husband's control was evident from the provisions of the trust deed. He had full control of the assets of the trust and used the trust as a vehicle for his business activities. He had the right unilaterally to remove a trustee and appoint someone else in his place. He ran the trust without consulting his co-trustee, and did not recognise the difference between trust assets and his own assets when it came to credit, loans, insurance and trust income.

2.2 Characteristics of trusts

A trust is a device that allows legal ownership to be separated from beneficial ownership. Generally, under a trust, legal or equitable title to property vests in a trustee for the purposes of being applied for the benefit of another, known as the beneficiary. The trustee must deal with the trust property for the benefit of the beneficiary.[18]

The trust has no separate legal personality (except for taxation purposes). A business carried on by trustees therefore enjoys a form of limited liability, independently of the provisions of the Companies Act.[19]

Trust property is held separately from the private assets of the trustee. The trust creditors and the beneficiaries may sue the trustee in respect of his or her conduct as trustee and may only execute against the trust property. A beneficiary may sue a trustee in his personal capacity only if the trustee has been guilty of a personal default such as a breach of trust.

The core idea of the trust is the separation of ownership or control from enjoyment of the trust property. Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interest of another. For this reason a sole trustee cannot

also be the sole beneficiary: Such a situation would embody an identity of interests that is inimical to the trust idea, and no trust would come into existence.[20]

Nel and others v Metequity and another [21]

When sued by a creditor under a suretyship, the sureties of a debt owed to a trust claimed that the trust was not a valid trust in that there was an identity of interests between the trustees and the beneficiary. They had the same shareholder and the same directors.

The court held that the mere fact that two companies have the same shareholder and the same directors does not constitute a basis for disregarding the separate legal personalities of the two companies. The court will generally pierce the veil of corporate personality only where there has been an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs.

A trustee must act with the standard of care, diligence and skill reasonably expected of a person who manages the affairs of another. A trustee cannot indemnify himself against liability to act with the required standard. The Master may call upon a trustee to account for his or her administration and disposal of trust property.

2.3 Elements of trusts

In the commercial sense, trusts are comprised of the following:

- **Settlor**: This person actually creates the trust by making a settlement of property on the trustee on terms that it should be held by the trustee for the beneficiary. The settlement may be by way of gift.
- **Trustee**: The trustee may be one or more natural or juristic persons. The trustee is the legal owner of the property settled by the settlor. For example, if the property is land, then the trustee will be the registered legal owner of the land. In exercising the rights of that legal ownership, the trustee must act for the benefit of the beneficiary in accordance with the terms of the trust.
- **Trust property**: This is the subject matter of the trust. It may be any type of property, real or personal, tangible or incorporeal. It is in respect of this property that the beneficiary has an equitable interest requiring the trustee to act in accordance with specific fiduciary duties. At the commencement of the trust, the property will comprise whatever was

settled by the settlor. During the operation of the trust, the trust property may be extended by further settlements, by property acquired by the trustee on behalf of the trust, or by accumulations of income or capital.

- **Beneficiary**: The beneficiary is the person for whose benefit the trust was created. The beneficiary holds the equitable interest, though not a legal interest. The trustee may also be a beneficiary. The beneficiary need not be in existence at the time the trust is created.

2.4 Duties of the trustee

These duties include:

- To act in accordance with the terms of the trust.
- To preserve the trust property.
- To not deal with the trust property for his or her own benefit.
- To ensure that the trustee's personal interests do not come into any position of conflict with the trustee's duty.
- The trustee has an obligation to deal with the trust property on behalf of the beneficiary, and not selfishly. The terms of the obligation are normally set out in detail in a written trust deed.

Our courts have previously suggested that the Master of the High Court should insist on at least one ‘independent’ trustee prior to registering a trust.[22] This might assist in reducing the abuse of the trust form. The court said that the essential notion of trust law, from which the further development of the trust form must proceed, is that enjoyment and control should be functionally separate. The duties imposed on trustees, and the standard of care exacted of them, derive from this principle.

The court suggested that the independent outsider should not have to be a professional person, such as an attorney or accountant. Rather it should be someone who, with proper realisation of the responsibilities of trusteeship, accepts office in order to ensure that the trust functions properly, and that the provisions of the trust deed are observed. He or she would monitor the conduct of the trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed. The outsider should not accept office without being aware that failure to observe these duties may risk action for breach of trust.

It has been suggested that separation of control and benefit would tend to ensure independence of judgement as it removes conflict of interest and facilitates impartiality. However, this is also achieved by an appreciation by the trustee of his or her duties and of the standard of care required.

Academics have suggested that it is not the separation as such that secures diligence. Whether the trustee is a beneficiary or not, diligence is secured by the knowledge that an action could be brought following a lapse on his or her part. The action could be brought against the trustee not only by a beneficiary, but by any affected party.[23]

One potential remedy would be for trustees to incur criminal liability for fraud or misrepresentation if they knew or ought to have known that they were acting without authority. Other solutions suggested include the following:

- The Turquand rule may safeguard outsiders from unwarranted contestation of liability by trusts that conclude business transactions. The Turquand rule is covered in chapter 27 in this text dealing with corporations.[24]
- An inference may be drawn that the trustee who concluded an allegedly unauthorised transaction was in fact authorised to conduct the business as the agent of the other trustees.[25]
- The trustees' conduct may invite the inference that the trust form was a mere cover and a veneer that should be pierced in the interests of creditors.[26]
- The Master of the High Court should ensure that an adequate separation of control from enjoyment is maintained in every trust. This suggestion has been criticised, however, since it is likely that a completely independent trustee would require adequate remuneration for his or her services. A completely independent trustee, not knowing the family and all the founder's reasons for creating the trust, especially where the trust is a discretionary trust which is the mode for family trusts these days, may frustrate the founder's intentions. The Master of the High Court will not have the expertise or the time to decide, without legislative criteria, who would in any particular case be an independent trustee.[27]
- Educating trustees, and dissuading them from introducing business ethics into the context of a trust. They must be made aware of the

seriousness of the duties they have taken on and of the consequences of falling down on their duties.[28]

- Trustees should warrant that they have educated themselves, and the Master should refuse to dispense with the provision of security unless each trustee signs an acknowledgement that they are aware of their duties. These could also be detailed in the document with an extract of section 9 of the Trust Property Control Act[29] acknowledging that the trustee could be exposing himself or herself to civil and criminal action.[30]

2.5 Legal personality of trusts[31]

The Trust Property Control Act[32] governs the formation and operation of trusts in South Africa.

Trustees must lodge the trust deed and any amendments with the Master of the High Court and must obtain written authorisation from the Master before they are permitted to act in the capacity of trustee. The grant of such authorisation requires the furnishing of security or being exempted from doing so. A court has the discretion to vary the provisions of a trust or even to order the termination of the trust to protect the achievement of the founder's objects, the interests of beneficiaries or the public interest.

Peterson and another NNO v Claassen and others[33]

The court distinguished between the object of a trust and the purpose of a trust. In this case the joint liquidators of several linked insolvent estates applied to court to set aside the transfer of immovable properties to certain trusts. They alleged that the trusts had been created solely for the fraudulent purpose of stripping the insolvent entities of their assets and to place them beyond the reach of their creditors. They argued that since the transferee trusts had been created for an unlawful purpose they were void *ab initio*; that the sales of the properties to the transferee trusts were therefore also void and had to be set aside; and that the mortgage bonds registered over the properties in favour of the bank were therefore also void.

The bank argued that the purpose for which a trust was created, as opposed to its object, did not render it void, but might only render specific transactions void.

The court held that while the object of a trust had to be lawful, it did not follow automatically that a trust was void if it had been created for an unlawful purpose. The better view was that agreements that the trust thereafter entered into might be void or voidable, in accordance with ordinary contractual principles, depending on the circumstances of each case.

In the present case the objects of the trusts were lawful, and since the bank was unaware of the alleged illegal purpose for which the trusts were allegedly created, it could not be said that the appointment of the trustee of the trusts involved was invalid or that the alienation or burdening of the properties had no legal force. Because the transferee trusts had purchased the properties in good faith and for value, the liquidators had no right to have the sales set aside.

Rules applicable to trusts are largely determined by the contents of the trust deed. There is no provision for formal maintenance of capital, solvency or liquidity requirements. Trust income is taxed at a rate of 40 per cent. Income vesting in or awarded to beneficiaries within a tax year is not taxed in the hands of the trustee but is taxed only in the hands of the beneficiary at his or her applicable rate.

Through a trust, a business can be carried on by trustees for the benefit of nominated beneficiaries. The trust provides limited liability in that neither the trustees nor the beneficiaries are liable for the obligations of the trust.[34]

A trading trust is a form of unincorporated business entity created by a deed. Property is held and managed by trustees for the benefit and profit of beneficiaries designated in the deed. Trusts where the general public is invited to become income beneficiaries are governed by the Unit Trust Control Act.[35]

The trust does not have a separate legal personality (other than for taxation purposes). The trust assets vest in the trustees who hold them for the benefit of others. This means that a trust cannot sue or be sued in its own name. Rather, it is the trustees acting on behalf of a trust that are the only ones who can sue or be sued.

A trading trust previously provided certain tax advantages while still preserving the limited liability of the trustees. The introduction of capital gains tax and changes to income tax rates have reduced these advantages. In general, a trading trust is not a separate juristic person distinct from its trustees. However, for income tax, VAT and transfer duty purposes, a trading trust may be treated as a separate person.

The number of trustees of a trading trust was previously limited to 20 persons in terms of the former Companies Act.[36]

Trustees require the authorisation of the Master of the High Court to act as trustees. Actions by trustees prior to the issue of such authorisation are

void.

Trading trusts are not widely used in South Africa today but may still be appropriate for certain types of businesses, for example in property development.

2.6 Advantages of using trusts for business purposes[37]

There are advantages of using a trust to operate a business as compared to operating under a company:

- A trust has limited liability because neither the trustees nor the beneficiaries are liable for obligations incurred by the trustees on behalf of the trust.[38]
- If income is distributed by a trust, this income is considered to be the income of the recipients.
- The legislation applicable to companies does not apply. This means it is not necessary to comply with the many requirements of the statutes, or numerous schedules and forms. For example, a trust does not have to prepare financial statements or be audited; it does not have to make annual returns; there is no limitation on the qualification of persons who may act as trustees; there is no restriction on the use of trust capital to finance the acquisition of interests in the trust; the provisions dealing with winding-up do not apply; there are no restrictions on the way in which decisions can be taken or in respect of the enlargement of the trust capital or as to what may be provided in the trust deed of amendments of the trust deed.
- Although a trust deed has to be lodged with the Master of the High Court, greater secrecy as to the interests and operations of the trust is possible.

2.7 Trusts and partnerships compared[39]

Compared to a partnership, the advantages of a trading trust include:

- Perpetual succession. On the departure, death or insolvency of a partner, the partnership terminates.

- The management of a partnership is more cumbersome, since all the partners are entitled to participate.
- General partnerships offer no limited liability.
- Membership of a business partnership is limited to 20 persons; there is no limitation on the number of trust beneficiaries.

3 Co-operatives

A co-operative is a voluntary association of persons who jointly own and control an enterprise to meet specified collective economic goals. The enterprise is run on democratic principles.

The purpose of the Co-operatives Act[40] is to promote the development of sustainable co-operatives that comply with co-operative principles. This will increase the number and variety of economic enterprises operating in the formal economy. The Act allows co-operative enterprises to register and acquire a legal status separate from their members.

A co-operative must comply with co-operative principles. This means that:

- Membership must be open to anyone who can use the services and who is able to accept the responsibilities of membership.
- In the case of a primary co-operative, each member has only one vote.
- The constitution of a secondary or tertiary co-operative may provide that the members have more than one vote; in the case of a secondary co-operative no member can have more than 15 per cent of the vote of all the members of the co-operative.
- Members should provide all the capital required by the co-operative, and the money paid back is limited to the maximum percentage allowed by the constitution of the co-operative.
- At least five per cent of any surplus must be set aside as a reserve in a special fund, and is not divisible amongst members.
- Education and training must be provided to members and employees.

3.1 Forms and kinds of co-operatives

The Act[41] provides for the registration of the following forms of co-operatives:

- **Primary co-operative**: Formed by a minimum of five natural persons whose object is to provide employment or services to its members and to facilitate community development.
- **Secondary co-operative**: Formed by two or more primary co-operatives to provide sectoral services to its members, and may include juristic

persons.
- **Tertiary co-operative**: Members are secondary co-operatives and whose object is to advocate and engage organs of State, the private sector and stakeholders on behalf of its members. A tertiary co-operative may also be referred to as a ‘co-operative apex’.

Co-operatives may operate in various fields:

- **Housing co-operative**: provides housing to its members.
- **Worker co-operative**: provides employment to its members.
- **Social co-operative**: provides social services to its members, such as care for the elderly, children and the sick.
- **Agricultural co-operative**: produces, processes or markets agricultural products and services.
- **Co-operative burial society**: provides funeral benefits, including funeral insurance and other services to its members and their dependants.
- **Financial services co-operative**: provides financial services to its members.
- **Consumer co-operative**: obtains and distributes goods or commodities to its members and non-members.
- **Marketing and supply co-operative**: obtains supplies and markets or processes products of members.
- **Service co-operative**: provides housing, health care, child care, transportation, communication and other services.

3.2 Registration

An application to register a co-operative must be made by:

- Five or more persons in the case of a primary co-operative.
- Two or more primary co-operatives in the case of a secondary co-operative.
- Two or more secondary co-operatives in the case of a tertiary co-operative.

The application must be submitted to the registrar in the prescribed form, and must be accompanied by the constitution of the co-operative signed by

the founder members, a list of the founder members, a list of the directors, and the prescribed fee.

The words ‘co-operative’ or ‘co-op’ must be part of its name. The word ‘limited’ or the abbreviation ‘Ltd’ must be the last word of its name, unless the constitution does not limit the liability of its members.

If satisfied that the Act[42] has been complied with, the registrar will issue a certificate of registration with a registration number. From the date the certificate is issued, the co-operative is incorporated as a legal person.

3.3 The constitution

The constitution of a co-operative must include:

- The name of the co-operative, and whether it is a primary co-operative, a secondary co-operative, or a tertiary co-operative.
- The main objectives of the co-operative and a description of the business of the co-operative, including any restrictions.
- The rights and obligations of members, and a provision that each member has one vote in all meetings of the co-operative except in the case of secondary or tertiary co-operatives.
- The place where the registered office of the co-operative is located.
- The minimum and maximum number of directors and their terms of office, which may not be more than four years.
- The powers and restrictions on the directors of the co-operative to manage the business of the co-operative.
- The requirements for membership and for withdrawal of membership.
- Details for the transfer of a surplus to a reserve fund, and how this fund may be utilised.
- The distribution of the assets of the co-operative on its dissolution.
- Provisions for general meetings and annual general meetings, including the manner in which such meetings are convened, quorums, the necessary periods of notice, voting, the election of a chairperson, appointment of directors, and provisions to ensure democratic decision making.

A co-operative may amend its constitution by a ‘special resolution’. This means that at least two-thirds of the members present at a general meeting

must be in favour of the resolution.

3.4 Liability of members

The liability of a member is limited to an amount equal to the nominal value of the shares that the member holds in the co-operative, for which the member has not paid.

3.5 Structure for decision making

The highest decision-making structure of a co-operative is a general meeting of members. A co-operative must hold its first annual general meeting within 18 months of its registration, and subsequent annual general meetings within six months after the end of the preceding financial year. The annual general meeting must appoint an auditor; approve a report of the board on the affairs of the co-operative for the previous financial year; approve the financial statements and auditor's report where applicable for the previous financial year; elect directors and a supervisory committee, if required by the constitution; and decide on the future business of the co-operative.

A director or manager of a co-operative must disclose in writing the nature and extent of any interest that he or she has in a proposed material contract or transaction with the co-operative.

A director or manager may not accept any commission, remuneration or reward from any person in connection with any transaction with the co-operative, unless this is paid in the course of the usual business or profession of the director or manager and they have disclosed their interest to the co-operative.

3.6 Capital structure

The capital contributed by members may comprise entrance fees; membership fees or subscriptions; consideration for membership shares or additional shares in a co-operative; member loans; and funds of members.

3.7 Patronage proportion

A co-operative may allocate and credit or pay to its members a portion of the surplus that is not transferred to a reserve fund. This allocation must be made according to the ‘patronage proportion’. This means the proportion that the value of the transactions conducted by a member with a co-operative during a specified period bears to the value of the transactions conducted by all members with a co-operative during the same period.

3.8 Termination

The winding-up of a co-operative may be voluntary or compulsory.

3.8.1 Voluntary winding-up

A co-operative may be wound up voluntarily by a special resolution of at least 75 per cent of its members.

3.8.2 Winding-up by order of court

A court may order that a co-operative be wound up, if it is unable to pay its debts; there is no reasonable probability that it will be able to pay its debts or become a viable co-operative; or if it appears just and equitable to do so.

As an alternative to winding-up, a court may grant a judicial management order if there is a reasonable probability that the co-operative will then be able to pay its debts or to meet its obligations and become a viable co-operative.

3.8.3 Winding-up or deregistration by order of Minister

The Minister may, on the recommendation of the registrar, order that a co-operative be wound up or deregistered if the Minister has reason to believe that the co-operative obtained registration through fraud; was formed for a particular period or until the occurrence of a particular event and that period has expired or that event has occurred; has not transacted business during a continuous period of two years; or is not operating in accordance with its constitution or the Act.[43]

3.9 Penalties

An offence in terms of the Act[44] carries a penalty on conviction to a fine or to imprisonment for a period up to 24 months, or to both.

PRACTICALLY

SPEAKING

Ten things to think about before choosing how your business will be structured[45]

1. **Cost**: A sole proprietorship and a general partnership can be set up very inexpensively. A limited partnership and a limited liability company are more expensive to set up. Setting up a corporation can be an expensive undertaking, and will require annual costs for accounting and auditing.
2. **Ease**: A sole proprietorship is easy to set up. Sometimes all it takes is opening up a business cheque account. Similarly, a general partnership is easy to set up, although a partnership agreement is something that the partners should create prior to beginning operations. A company involves more work.
3. **Termination**: Some business entities automatically terminate upon events such as death, the withdrawal of a partner, or even divorce.
4. **Public information**: How much information do you want the public to know about your business and finances? A company is required to provide much more information to the State, which is then available to the public, than a partnership. Sole proprietorships and general partnerships offer the individuals involved a greater deal of privacy.
5. **Risk**: If the business involves a great deal of risk, a sole proprietorship or general partnership may be a bad idea because the owner and general partners are personally liable for the business debts and obligations.
6. **Operation**: The form of the business entity may dictate how it is operated. If you want total control, a sole proprietorship provides the businessperson the greatest degree of control and the greatest degree of potential risk.
7. **Capitalisation**: Who will provide the money to start up the business? Will it be necessary to get loans and security? Some business forms make it easier to raise capital when it is needed.
8. **Selling**: A sole proprietorship is easy to sell; usually you sell the assets of the business, and your business ceases to exist. Selling a partnership interest can be tricky because it may require approval of the other partners.
9. **Expansion**: Every entrepreneur wants to be as successful as possible. Some business entities are limited to the number of shareholders they may have. A sole proprietorship ceases to exist the moment the sole proprietor takes on a partner. It is important to choose a business form that allows you the greatest room to grow if that is what you envision. Although the business form may be changed, this involves additional expense and energy.
10. **Internal rules**: If more than one person owns a part of the business, it is useful to get a prior written agreement. The document will set out which person does what, the things and amounts which people will contribute, how decisions must be taken, and how to resolve disputes.

THIS CHAPTER IN ESSENCE

1 A close corporation is a juristic person endowed by the Close Corporations Act with legal personality and has powers similar to those of a company.
2 A maximum of ten natural persons may be members and hold an interest in a close corporation expressed as a percentage.
3 Every member of a close corporation is an agent of the close corporation for all purposes.
4 In some cases, members can be held personally liable for losses incurred by a close corporation or for its debts.
5 The doctrine of constructive notice does not apply to a founding statement of a close corporation.
6 The Companies Act does not allow new close corporations to be registered, and existing close corporations will be phased out and converted into companies by 2020.
7 The Trust Property Control Act governs the formation and operation of trusts in South Africa.
8 A trust has limited liability because neither the trustees nor the beneficiaries are liable for obligations incurred by the trustees on behalf of the trust.
9 The basic idea of the trust is the separation of ownership from use of the trust property. The person entrusted with control exercises it on behalf of and in the interest of another. Under a trust, legal or equitable title to property vests in a trustee for the purposes of being applied for the benefit of another, known as the beneficiary.
10 The trustee must deal with trust property for the benefit of the beneficiary. Trust property is held separately from the private assets of the trustee.
11 A trustee must act with the standard of care, diligence and skill reasonably expected of a person who manages the affairs of another.
12 A co-operative is a voluntary association of persons who jointly own and control an enterprise to meet specified collective economic goals. The enterprise is run on democratic principles.

13 The Co-operatives Act allows co-operative enterprises to register and acquire a legal status separate from their members, and allows for registration of different forms of co-operatives.
14 The liability of a member is limited to an amount equal to the nominal value of the shares that the member holds in the co-operative, for which the member has not paid.

QUESTIONS

Short questions (1–5 marks)

1. Identify the four elements of trusts.
2. List five duties of a trustee.
3. Identify the advantages of using trusts for business purposes.
4. Define what is meant by a co-operative.
5. List three forms of co-operative.
6. List eight items that the constitution of a co-operative must include.

Paragraph questions (5 marks)

1. Identify what is meant by a founding statement.
2. Describe what it means when we say that a close corporation has limited liability.
3. Discuss the circumstances in which a member of a close corporation can incur personal liability for contracts entered into by the CC.
4. Discuss the relevance of keeping accounting records, and the kinds of records that must be kept by a close corporation.
5. Discuss what is meant by a trust.
6. Discuss the duties of a trustee.
7. Outline the advantages of using trusts for business purposes.
8. Discuss forms and types of co-operative.

Essay questions (10 marks)

1. Compare a close corporation with a company.
2. Discuss the concept of liability and limited liability in three forms of business enterprise.

1 Close Corporations Act 69 of 1984.

2 Gibson, 447–458; Havenga et al., 161–162.

3 Investment Vehicles, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

4 Companies Act 71 of 2008.

5 Close Corporations Act 69 of 1984.

6 Close Corporations, *Doing Business in South Africa*, Sandton: Deneys Reitz Attorneys March 2005.

7 *J and K Timbers (Pty) Ltd t/a Tegs Timbers v GL and S Furniture Enterprises CC* 2005 (3) SA 223 (N).

8 *Hanekom v Builders Market Klerksdorp (Pty) Ltd and others* 2006 (1) SA 423 (T).

9 Close Corporations Act 69 of 1984.

10 Investment Vehicles, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

11 Close Corporations, *Doing Business in South Africa*, Sandton: Deneys Reitz Attorneys March 2005.

12 Companies Act 71 of 2008.

13 Chaplin, V, A Practical Guide to the Implications of the New Companies Act – Classification of Companies, *De Rebus* Pretoria: Law Society of South Africa, March 2010.

14 *Crookes NO and another v Watson and others* 1956 (1) SA 277 (A).

15 *Crookes NO and another v Watson and others* 1956 (1) SA 277 (A); *Hofer and others v Kevitt NO and others* [1997] 4 All SA 620 (A).

16 Joffe, H, 'Sham' trusts - The future of trust law, *De Rebus*, Pretoria: Law Society of South Africa, February 2007.

17 *Badenhorst v Badenhorst* [2006] 2 All SA 363 (SCA).

18 Singh, N, Trusts, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

19 Companies Act 71 of 2008.

20 *Land and Agricultural Bank of South Africa v Parker and others* 2005 (2) SA 77 (SCA).

21 *Nel and others v Metequity and another* 2007 (3) SA 34 (SCA).

22 *Land and Agricultural Bank of South Africa v Parker and others* 2005 (2) SA 77 (SCA).

23 Kernick, L, Declaration of independence, *De Rebus*, Pretoria: Law Society of South Africa, February 2007.

24 Ibid.

25 Ibid.

26 Ibid.

27 Ibid.

28 Ibid.

29 Trust Property Control Act 57 of 1988.

30 Kernick, L, Declaration of independence, *De Rebus*, Pretoria: Law Society of South Africa, February 2007.

31 Singh, N, Trusts, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

32 Trust Property Control Act 57 of 1988.

33 *Peterson and another NNO v Claassen and others* 2006 (5) SA 191 (C).

34 Business Entities, *Doing Business in South Africa*, Sandton: Deneys Reitz Attorneys March 2005.

35 Unit Trust Control Act 54 of 1981.

36 Companies Act 61 of 1973.

37 Trusts, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

38 Business Entities, *Doing Business in South Africa*, Sandton: Deneys Reitz Attorneys March 2005.

39 Trusts, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

40 Co-operatives Act 14 of 2005.

41 Ibid.

42 Co-operatives Act 14 of 2005.

43 Co-operatives Act 14 of 2005.

44 Ibid.

45 Source: http://smallbusiness.findlaw.com, accessed 28 July 2008. Copyright © 2011 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 27

Corporations

'We are the 99%'

POLITICAL SLOGAN
REFERRING TO THE INCREASED CONCENTRATION OF WEALTH AMONGST THE TOP 1% OF INCOME EARNERS

What is covered in this chapter

1 Distinguishing features of a corporation
2 Comparison between a sole trader, partnership, company and a close corporation
3 Relationship between a company and outsiders
4 The Companies Act
5 Types of companies
6 Legal status of companies
7 Registered office and records
8 Shareholder rights to information
9 Dissolving companies
10 Securities
11 Distributions by the company
12 Public security offerings
13 Shareholders
14 Board and directors
15 Financial year of company

16 Accounting records and statements
17 The appointment of a company secretary, auditor, audit committee, and social and ethics committee
18 Takeovers, offers and fundamental transactions
19 Business rescue proceedings
20 Remedies and enforcement
21 Offences and penalties
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

Company law governs the way that a company is created, how it conducts its activities and how it must eventually cease to exist. Company law has a direct impact on the way local and global business is transacted. It is critical that South Africa's company laws stimulate and support economic growth, investor confidence and foreign investment.

Global travel, communication and internet buying have resulted in huge growth of cross-border financial transactions. Increasingly, people invest money in companies whose shares are traded on international stock markets. Globalisation of businesses has also led to increased demands by businesses for harmonisation of the laws governing international business deals.

In some cases the influence of large corporations has led to an abuse of powers by some, to the detriment of the public. Governments around the world have responded by regulating companies more strictly and imposing more severe penalties on directors who abuse their powers or neglect their duties.

Companies have also been made accountable to their stakeholders, including employees, minority shareholders (being the general public in the case of listed companies), the communities in which they conduct their business activities, and even society as a whole. This has been done by requiring more disclosure of their business activities, introducing stricter accounting requirements and introducing more laws to ensure that directors comply with their duties honestly, responsibly and diligently.

South Africa has passed several new laws over the past decade to reform the way that companies operate.[1] It is important that you understand how transparency, accountability and proper corporate governance now play a central role in modern business.[2]

1 Distinguishing features of a corporation

The term ‘corporation’ is used to denote both companies and close corporations. There are many differences between a partnership and a corporation.[3]

- **A corporation is a separate legal entity distinct from its shareholders or members**: A corporation is an association of parties, created and recognised by law as a separate legal entity, in terms of which the shareholders (in the case of a company) or the members (in the case of a close corporation) generally contribute capital or skills to attain profits. A corporation, although having no physical attributes, is regarded by law as a juristic person, a legal person entirely separate from the shareholders or members who comprise it.[4]

  A partnership is a contract (and the legal relationship created by that contract) between at least two natural persons, in which the persons concerned agree to contribute money, labour, or skill in a common stock and carry on business with the object of making a profit for their joint benefit. A partnership does not have a legal existence separate from that of its partners.[5]

  A partnership is an association of persons, but a corporation is a legal person in itself. A corporation is distinct from the individuals that formed it. It has the capacity to acquire and bear rights and duties distinct from those of its shareholders or members, or the rights and duties of the individuals forming it.[6]

Salomon v Salomon and Co Ltd [7]

A sole proprietor converted his business into a limited company after he had entered into a pre-incorporation contract that effectively made him, his wife, and their five children preferential creditors. On insolvency of the company, the ordinary creditors were left without any money, and sued.

The court found that the company was a separate legal entity distinct from its members.

Dadoo Ltd and others v Krugersdorp Municipal Council [8]

The owner of a company owned by Indians bought a stand in an area reserved for ownership of other race groups.

The court held that the company was a legal entity separate from that of its members and that the ownership was not prohibited by the law.

Generally, a juristic person enjoys rights and obligations that are different from those enjoyed by a natural person. For example, a juristic person is not able to marry, be assaulted, or have its privacy invaded. It cannot be a guardian of a minor and cannot appear in court in person.[9]

The consequence of this separate identity is that the business of a company is its own business, and not the business of its shareholders or members.[10] Shareholders and members have proprietary interests in the corporation, not in the business run by the corporation. Property owned by the corporation belongs to the corporation itself, and cannot be treated as if it were owned by shareholders or members.[11] Debts of the corporation cannot be regarded as debts of shareholders or members.[12] Only a juristic person may sue for delicts committed against it. A shareholder or member similarly is not liable for delicts committed by the corporation, unless her or she were personally involved in having committed the delict.[13]

A juristic person cannot be imprisoned for any crime, since it has no body. However, it may be fined. The directing mind and will of a company may be found in its board of directors,[14] and of a close corporation in its members acting jointly.

If, however, corporate personality has been used as a device to conceal fraud or improper conduct, or if a statute requires it, the courts will ‘pierce the veil’ of corporate personality to expose the impropriety.

The courts will pierce the corporate veil in any of the following circumstances:

- To give effect to the intention of the legislature.[15]
- To prevent the concealment of fraud or the breach of fiduciary duties.[16]
- To prevent the improper evasion of obligations.[17]
- Whenever the court deems it to be in the public interest.[18]
- **Shareholders or members in a corporation enjoy limited liability**: Generally, a partner is jointly and severally liable for all partnership debts. This means that each partner is individually and fully liable for the total debt. Each partner also is liable for his or her portion of the debts incurred by the partnership.

  In contrast, ordinarily the liability of a shareholder of a company is limited either to the amount unpaid on shares held by that shareholder,

or to an amount that that shareholder may have undertaken to contribute to the assets of the company in the event of it being wound up.[19] The liability of a member of a close corporation is limited to the amount of the contribution that that member has given or agreed to give.

- **A corporation has perpetual succession**: A partnership is dissolved on the death or retirement of any partner. A corporation continues to exist even though the individual members may change. This perpetual succession continues until the corporation is wound up or dissolved, even if all the original members of the corporation have changed or ceased to exist.[20]
- **Transfer of interest differs**: A partner cannot transfer his or her interest in the partnership without the express agreement of all the partners. This effectively terminates the original partnership and forms a new one. A shareholder of a corporation may transfer shares freely, except where this right is restricted by the Articles of Association, as in the case of a private company. A member of a close corporation may only transfer a membership interest to another natural person.
- **Agency differs**: Each partner may bind the partnership legally to a contract. A shareholder or a member of a corporation may not automatically be able to do so. A partner has implied authority to act as agent for and to bind the partnership, provided he or she acts within the course and scope of the partnership business. A shareholder has no implied authority whatever to act as agent for the corporation. A company acts through its directors, whose powers are given to them by the Memorandum of Incorporation. A close corporation acts through its members whose powers are set out in the Close Corporations Act.[21]
- **Formation differs**: Corporations are formed through a process of registration. There are no formalities for the creation of a partnership.
- **The numbers of partners, shareholders, and members allowed differs**: A partnership must comprise two or more natural persons. A minimum of one person may hold shares in a profit company, and three in a non-profit company. A close corporation is limited to a minimum of one and a maximum of ten natural persons as members.[22]
- **Applicable legislation differs**: The Companies Act[23] governs companies. There is no separate Act governing partnerships. The Close Corporations Act[24] governs close corporations.

- **Distribution of profits differs**.
- **Tax rates and their methods of calculation differ**.
- **Realisation of investments in each differs**.

2 Comparison between a sole trader, partnership, company and a close corporation

This is illustrated in Table 27.1.

Table 27.1 *Sole trader, partnership, company and a close corporation*

	Sole trader	**Partnership**	**Company**	**Close corporation**
Separate legal identity	No. Private individual.	No. Private individuals or entities.	Yes.	Yes.
Ownership of property	The trader.	The partners.	The company itself.	The close corporation itself.
Can creditors attach private goods?	Yes.	Yes, but partnership assets must be exhausted first.	No.	No.
Liability for debts	The trader personally.	The partners personally.	The company itself; not the shareholders.	The close corporation itself; not the members.
Extent of the liability	Unlimited.	Unlimited, except for a commanditarian partnership.	Limited to the value of the share capital.	Limited to the value of the members' contributions.
Capacity to contract	The trader.	Usually any one of the partners.	Directors and authorised company agents; not the shareholders.	Members and authorised close corporation agents.
Minimum number of participants	One.	Two.	One (profit company); three of more (non-profit company).	One.
Maximum number of participants	One.	No limit.	No limit.	Ten.
Liability for tax	Trader.	Partners as individuals.	The company.	The close corporation.
On death of a participant	Business terminates.	Partnership ceases, but may be reinstated.	No change; company can exist indefinitely.	No change; close corporation can exist indefinitely.

3 Relationship between a company and outsiders

The scope of authority that an agent of a company may possess differs from one company to another and usually is laid down in the Memorandum of Incorporation. These agents include bodies such as the members in general meeting, the directorate, committees of directors, and individuals such as the managing director or an individual director.

However, if the Memorandum of Incorporation limits the power or authority that an agent may possess, any outsider is deemed to be aware of this limitation and by law is prevented from relying on this lack of authority in any court action. Therefore, the ‘doctrine of constructive notice’ is said to apply to the advantage of the company and to the prejudice of outsiders.

To be exercised properly, agency generally requires compliance with certain formalities. For example, the board of directors may issue shares, provided the consent of the company in general meeting is obtained first. Any person reading the Memorandum of Incorporation would see that the board has the power to issue shares, subject to the sanction of the general meeting. Since no publicity is given to compliance with these internal formalities, the law states that the outsider need not make further enquiries about whether these formalities have been complied with in fact. A third party, therefore, is entitled to assume there has been compliance with the formalities and will be protected in the event that there has not been. The outsider is protected by what is now called the Turquand Rule.

Royal British Bank v Turquand [25]

The Turquand Rule developed from the decision in this 1856 case where directors were limited to borrowing amounts that were authorised by an ordinary resolution passed at a general meeting. The directors borrowed money, but without the necessary authority. When the company was sued for repayment, it defended the claim by stating that there had been no resolution authorising the borrowing.

The court held that the company was bound. As a general principle, an act done contrary to, or outside of the scope of the company's constitution, did not bind the company, unless the company ratified what was done. Outsiders at any time could inspect the Memorandum of Incorporation in order to find out if a special resolution had been passed. All the relevant documents were public documents that could be

inspected, and the outsider was deemed to know their contents. His or her ignorance of their provisions was no excuse.

The court therefore held that where acts were not prohibited, but could be done by directors subject only to certain internal management processes being adhered to, a person dealing with the company was entitled to assume that they had been satisfied, unless he or she knew or ought to have known that they had not been. No protection under the Turquand Rule would be given if the outsider knew that the formalities had not been complied with, or if the circumstances surrounding the negotiations were such that a reasonable person in the outsider's position would have been placed on his or her guard and would have enquired whether the formalities had been complied with. Here the outsider failed to do so.[26]

The Turquand Rule is also known as the ‘indoor management rule’. It is a means by which third parties are protected.[27] The rule states that, when a third party enters into a contract with a company, there is a legal presumption that all acts of the company's internal management have been properly carried out and the company will be bound to the contract even if it is proved that the necessary acts of internal management were not carried out, or were irregular or defective, or that the representative of the company had no authority to bind the company. For example, a necessary resolution was not passed.[28]

This rule often applies where a person, such as a director, enters into a contract on behalf of a company, stating that authority to represent the company has been delegated to him by the board of directors. If the delegation of authority is invalid because of a defect in the company's internal management, the third party will be protected by the Turquand Rule and the company will be bound to the contract. The application of the rule has been extended to include government departments, corporations, municipalities and other statutory bodies.[29]

***Potchefstroom se Stadsraad v Kotze*[30]**

Kotze had leased a farm from the council. He wanted to sub-let the farm. At a meeting with the town clerk it was agreed that he would vacate the farm and the lease would be cancelled. The town clerk wrote a letter to confirm this. However, the council had no record of any authority given to the town clerk to cancel the lease, nor did they have a copy of the letter in their records. The town clerk was deceased.

The court held that the fact the council had not authorised the cancellation was irrelevant; the council could not deny the authority of the town clerk and the letter did contain a notice of cancellation.

The Turquand Rule has now been included in the Companies Act.[31] The Act provides that a third party dealing with the company in good faith is entitled to assume that the company, in exercising its powers, has complied with all of the formal and procedural requirements in terms of the Act, the Memorandum of Incorporation and any other rules of the company.[32]

The Act relieves outsiders of the need to know whether any provisions of the Memorandum of Incorporation limit the company's powers and capacities to act. No act will be void simply because it was beyond the powers of the company. Neither the company nor an outsider may rely on the company's lack of capacity in order to avoid liability on a contract. A company may not state that its agent lacked the necessary authority to perform an act if the only reason for the lack of authority was the company's limitation of powers and capacities as described in the Memorandum of Incorporation.

4 The Companies Act[33]

The purposes of the Companies Act[34] are to provide for the incorporation, registration, capitalisation, organisation and management of companies. It does this by defining the relationships between companies and their shareholders and directors. It also provides for mergers, amalgamations and takeovers of companies, and for efficient rescue of failing companies.

4.1 Understanding the difference between a company and the persons controlling it

It is sometimes difficult to understand whether a juristic person is truly separate from the persons who control it. For this reason, the Act[35] defines several classes of relationship and relations between persons and entities.

4.1.1 Related and inter-related persons

The expression ‘related and inter-related persons’ covers both natural and juristic persons (the Act deems a juristic person to include a trust). It is used in the context of relationships between a company's shareholders or directors and others, called ‘related’ or ‘inter-related’ persons. ‘Related’ persons of a natural person include his or her spouse, children, grandchildren, parents, grandparents, siblings and in-laws.[36]

An individual is ‘related’ to a juristic person if that individual directly or indirectly controls the juristic person. Two companies are ‘related’ if either of them controls part of the business of the other; or one of them is a subsidiary of the other. ‘Inter-related’ persons are three or more persons linked to one another by any of these relationships.

Two or more persons are presumed to ‘act in concert’ if they are related or inter-related. The Act protects stakeholders in a company, particularly minority shareholders, against shareholders or directors taking unfair advantage of these relationships. It does so by requiring certain disclosures, or by treating all of them as a single person. For example, in some situations involving voting rights, the voting rights controlled by a

shareholder and that shareholder's related and inter-related persons, are both deemed to be controlled by that shareholder alone.[37]

4.1.2 Controlling and subsidiary relationships

A person ‘controls’ a juristic person, or all or part of its business, if the first person, directly or indirectly, has the power to determine substantially the policy and direction of the juristic person or its business.

A juristic person is a ‘subsidiary’ of another juristic person if more than 50 per cent of its shares are held by another juristic person, or by one or more of its wholly owned subsidiaries, or by their respective nominees.

A juristic person is a ‘wholly owned subsidiary’ of another juristic person if all of its shares are held by another juristic person, or by one or more of its wholly owned subsidiaries, or by their respective nominees.

5 Types of companies

The Act[38] creates two types of companies: profit companies and non-profit companies:

Table 27.2 *Types of companies created by the Companies Act*

	Type of company	Definition
1	Profit company	Incorporated by one or more persons for the purpose of financial gain for its shareholders.
2	Non-profit company	Owned by members, and incorporated for a public benefit or a purpose related to social or cultural activities, or communal or group interests. To identify it as a non-profit company, its name must end with the abbreviation 'NPC'.

There are four categories of profit companies:

Table 27.3 *Categories of profit companies*

	Category	Characteristics	Name
1	Private company	Memorandum of Incorporation prohibits the sale of its securities to the public, and restricts the transferability of its securities. This type of company can have any number of shareholders. If there are special conditions in the Memorandum of Incorporation that restrict the company's capacity, the letters ‘RF’ must appear after its name to bring attention to the special conditions.	Must end its name with ‘Proprietary Limited’ or the abbreviation ‘(Pty) Ltd’.
2	Public company	Not a private company, State-owned company or a personal liability company. This type of company is subject to additional financial reporting and auditing requirements.	Must end its name with ‘Limited’ or the abbreviation ‘Ltd’.
3	State-owned company	Must be a State-owned entity or owned by a municipality. This type of company is subject to additional financial reporting and auditing requirements.	Must end its name with the abbreviation ‘SOC Ltd’.
4	Personal liability company	Memorandum of Incorporation must state it is a personal liability company and meets criteria for a private company. The directors and past directors are jointly and severally liable with the company for its debts. This type of company is typically used by professional practices, such as lawyers and accountants.	Must end its name with ‘Incorporated’ or the abbreviation ‘Inc’.

‘External companies’ are foreign-owned companies registered to carry on business in South Africa. They may be profit or non-profit companies. They have a unique registration number indicating foreign jurisdiction.

6 Legal status of companies

A company is a juristic person with a legal identity created on registration. It continues in existence until its name is removed from the Companies Register.

6.1 Incorporation of companies

The formation of a company is an exercise of the constitutional right to freedom of association, combined with the common-law right to freedom of contract. The Act reflects the principle that incorporation of a company is a right, rather than a privilege bestowed by the State. The Act therefore provides for incorporation as of right, places minimal requirements on the act of incorporation, allows for maximum flexibility in the design and structure of the company, and significantly restricts the ambit of regulatory oversight on matters relating to company formation and design.

A company is formed by a process called ‘incorporation’. Incorporation means that the process required by the Act[39] has been complied with, and all the necessary documents are given to the correct government department. The company will come into existence on the date it is registered officially.

The first stage of the process requires the persons who will own or control the company to agree on a ‘Memorandum of Incorporation,’ which is the sole governing document of the company. The Act imposes certain specific requirements on the content of a Memorandum of Incorporation. These are necessary to protect the interests of shareholders in the company, and provide default rules for running the company. A standard form Memorandum of Incorporation is included in Schedule 1 of the Act.[40]

The second stage of the process requires the Memorandum of Incorporation and a document called a ‘Notice of Incorporation’ to be filed with the Companies and Intellectual Property Commission (CIPC). One or more persons may incorporate a profit company, or three or more persons may incorporate a non-profit company.

The third stage of the process requires the Commissioner at CIPC to provide a unique registration number, enter information about the company

in the Companies Register, and issue a registration certificate. A registration certificate is conclusive evidence that all the requirements for the incorporation of the company have been complied with.

The Act provides for the reservation and registration of company names. The name of a company may only be restricted as far as necessary to protect the public from misleading names which falsely imply an association that does not in fact exist; protect the interests of the owners of names and other forms of intellectual property from other persons passing themselves off on the first person's reputation; and protect society from names that are hateful or offensive.

If the name of the company is the same as a registered name of another company, or is reserved for another person, or does not satisfy the requirements of the Act, the commissioner must enter the interim name of the company in the register and on the registration certificate, and then ask the company to file an amended Notice of Incorporation using a satisfactory name.

6.2 Validity of company actions

An act of a company, other than an act that is in contravention of the Act,[41] is not void solely because the company did not have the capacity to do the act.

No person may rely on a lack of such capacity, power or authority except in legal proceedings:

- Between a company and its shareholders or directors;
- Between the shareholders and directors of a company; or
- Arising as a result of an act in contravention of the Act.

If a company's Memorandum of Incorporation limits the purposes, powers, or activities of the company, the shareholders by a special resolution may ratify any action that is inconsistent with the limitation. One or more shareholders, directors or other interested persons may take legal action to restrain the company from doing anything inconsistent with the limitation, without prejudice to any rights to damages of a third party who obtained those rights in good faith and did not have actual knowledge of the limitation.

Each shareholder of a company has a claim for damages against any person who causes the company to do anything inconsistent with a limitation, unless that action has been ratified by the shareholders.

6.3 Pre-incorporation contracts

A pre-incorporation contract contains an implied warranty by the person who enters into a contract in the name or on behalf of a company to be formed, that the company will be incorporated within any period specified in the contract or, if no period is specified, then within a reasonable time after the making of the contract; and that, once incorporated, the company will not repudiate the contract.

A company may repudiate a pre-incorporation contract unless it has received any benefit in terms of the contract. A pre-incorporation contract that has not been repudiated is as valid and enforceable as if the company had been a party to the contract when it was made.

A person who knows that a company does not exist and purports to act in the name of, or on behalf of, that company, is liable if the company is not incorporated, or after being incorporated, repudiates those acts.

7 Registered office and records

Each company or external company must continuously maintain a registered office in the Republic and register the address of that office by filing a Notice of Registered Office.

8 Shareholder rights to information

Shareholders have the right, on request made in good faith, to access, inspect and copy any of the records of the company at the registered office.

If at any time the company does not satisfy the solvency and liquidity test, and the board has not adopted a resolution to commence business-rescue proceedings, the board must within ten business days deliver a notice of that fact to the shareholders. Further status reports must be delivered every 60 business days thereafter until the company does satisfy that test.

9 Dissolving companies

A company may be dissolved by voluntary winding-up by the company itself, or by creditors, or winding-up and liquidation by court order.

9.1 Voluntary winding-up of company

A company may be wound up voluntarily if the company has adopted a special resolution for winding-up by the company or by creditors.

The company must arrange for security for the payment of the company's debts. The Master of the High Court may dispense with security if a sworn statement is submitted by the directors that the company has no debts, and this is supported by a certificate by the company's auditor.

From the start of the company's winding-up it must stop carrying on its business except to the extent required for the beneficial winding-up of the company.

9.2 Winding-up by court order

A court may order a company to be wound up if:

- The company has by special resolution resolved that it be wound up by the court or applied to the court to have its voluntary winding-up continued by the court.
- One or more of the company's creditors have applied to the court for an order to wind up the company on the grounds that the company appears to be insolvent; the company's business rescue proceedings have been rejected; or it is otherwise just and equitable for the company to be wound up.
- The supervisor of a company appointed during business-rescue proceedings has applied for liquidation on the grounds that there is no reasonable prospect of the company being rescued.
- The company, one or more directors, or one or more shareholders have applied to court for an order to wind up the company on the grounds that:

    - The directors are deadlocked in the management of the company and the shareholders are unable to break the deadlock. Either irreparable injury to the company could result from the deadlock or the company's business cannot be conducted to the advantage of shareholders as a result of the deadlock;
    - The shareholders are deadlocked in voting power, and have failed for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired; or
    - It is otherwise just and equitable for the company to be wound up.
- A shareholder has applied to a court for an order to wind up the company on the grounds that the directors, or other persons in control of the company are acting in a manner that is fraudulent or otherwise illegal, or the company's assets are being misapplied or wasted.
- The Commission or Takeover Regulation Panel has applied to the court for an order to wind up the company on the grounds that:
    - The company, its directors, or other persons in control of the company are acting in a manner that is fraudulent or otherwise illegal;
    - The Commission or Takeover Regulation Panel has previously issued a compliance notice in respect of that conduct, and the company has failed to comply with that notice;
    - The court has imposed an administrative fine in respect of the failure to comply with the compliance notice; and
    - The Commission or Takeover Regulation Panel has issued a second compliance notice in respect of the continuing conduct, and the company has failed to comply with that second compliance notice.

9.3 Dissolution of companies and removal from register

After the affairs of a company have been completely wound up, and a court order of final liquidation made, the Master must file a certificate to that effect, together with a copy of the court order. On receipt of this certificate, the Commissioner must record the dissolution of the company and remove the company's name from the Companies Register.

The Commissioner may also remove a company from the Companies Register only if the company appears to have been inactive for at least ten years, and no person has demonstrated a reasonable interest in its continued existence

For three years after deregistration, any assets of the company are trust property held for the joint benefit of the deregistered company, any person having an interest in its assets, and the State. Unless claimed they are then forfeited to the State.

9.4 Effect of removal of company from register

A company is dissolved as of the date its name is removed from the Companies Register.

10 Securities

The word ‘securities’ has a wide meaning and includes any shares, debentures or other instruments that give various forms of economic and voting rights in a company.

10.1 The solvency and liquidity test

Under previous company laws, creditors were meant to be protected by the ‘maintenance of capital’ rule. This required a company to maintain its share capital at the level of funding contributed by its shareholders. In this way a company could not weaken its financial position by paying a dividend unless its assets exceeded its liabilities. The theory was that creditors would be protected until the company was liquidated.

In reality, however, it became common practice for companies to issue shares at a nominal or ‘par’ value, and for the balances of investors' contributions to be regarded as interest-free loans. For example, shares issued at a par value of one cent per share, with a R1 million loan. The law regarding a shareholder's loan was no different to that of any other loan, meaning that the entire idea of maintaining a share capital to protect creditors simply did not work. The amount of share capital became irrelevant in the decision of a third party to grant credit to a company.[42]

Under the Companies Act,[43] provisions supporting the capital-maintenance rule have been abolished. Par value shares that were issued before 1 May 2010 continue to exist; however, from that date a company may only issue new shares of no par value.[44]

The Act gives far greater protection to creditors with the ‘solvency and liquidity test’. A company satisfies the solvency and liquidity test if both of the following two elements are satisfied:

- **It is solvent**: The company's total assets exceed its total liabilities. To work this out the company's balance sheet must be looked at; and
- **It is liquid**: It appears that the company will be able to pay its debts as they became due for the next 12 months. To work this out the company's cash flow statement must be looked at.

Under the Act, the solvency and liquidity test must be applied in each of the following situations:[45]

- The company provides financial assistance to itself so as to buy its own securities.
- Loans to directors and inter-group loans.
- Distributions of any nature, including dividends.
- Issue of capitalisation shares with a cash alternative.
- Share buy-backs.
- Amalgamations or mergers.
- A foreign company wants to transfer its registration to South Africa and become a ‘domesticated company’.

10.2 Authorising and issuing shares

A share represents one unit of ownership in a company. A share certificate issued by a company is movable property. The company's Memorandum of Incorporation sets out the classes of shares, and the number of shares of each class, that the company is authorised to issue. Each class of shares must also have a distinguishing designation, and the preferences, rights, limitations and other terms associated with that class are identified.

A company may issue shares only within the classes, and to the extent, set out in the Memorandum of Incorporation, or a resolution of the board. If a company issues shares without proper authorisation, the issuance of those shares may be retrospectively ratified by the board or the shareholders, or through an amendment to the Memorandum of Incorporation.

10.3 Preferences, rights, limitations and other terms

Every share issued by the company must have associated with it the right of the shareholder to vote on any proposal to amend the rights associated with that share.

The voting rights associated with any share are as set out in the Memorandum of Incorporation. This may establish, for any particular class of shares, preferences, rights, limitations or other terms that:

- Confer special, conditional, or limited voting rights, or no right to vote.

- Provide for shares of that class to be redeemable or convertible for cash, indebtedness, securities, or other property.
- Entitle the holders to distributions including dividends that may be cumulative, noncumulative, or partially cumulative.
- Provide for shares of that class to have preference over any other class of shares with respect to distributions including distributions upon the final liquidation of the company; or have no specified preferences.

10.4 Options for purchase of shares

An option or right given to a current or future director of a company to purchase shares or to take up debentures convertible into shares must be authorised by a special resolution of the company, and must be in accordance with an employee share scheme.

Any director who contravenes the Act is liable to compensate the company or any shareholder for any loss or damages the shareholders may incur.

10.5 Financial assistance for purchase of shares

A company must not give any financial assistance for the purchase of a share or option if the company's Memorandum of Incorporation expressly prohibits this.

However, financial assistance can be given if it is not expressly prohibited; the board is satisfied that immediately after giving the financial assistance the company would be in compliance with the solvency and liquidity test, and the terms under which the assistance is to be given are fair and reasonable to the company; all conditions and restrictions set out in the Memorandum of Incorporation must be satisfied; and the financial assistance is in terms of an employee share scheme, or in terms of a special resolution of the shareholders adopted within the previous five years.

A board resolution to provide financial assistance is void to the extent that the provision of that assistance would be inconsistent with a prohibition, condition or requirement of the Memorandum of Incorporation. Any director who in favour of such a resolution is liable to compensate the company or any shareholder for any loss, damages or costs sustained.

10.6 Debentures

A debenture is a form of unsecured debt backed only by the integrity of the borrower, not by collateral. It is documented by an agreement called an indenture. A debenture includes debenture stock, debenture bonds, common notes and any other debt security of a company, but does not include promissory notes and loans, whether constituting a charge on the assets of the company or not.

A company may create and issue debentures subject to the Memorandum of Incorporation.

11 Distributions by the company

No distribution may be made by a company unless it has been authorised by the company's board. The company must also satisfy the solvency and liquidity test after the authorisation.

If a director voted in favour of a distribution that did not satisfy the requirements of the Act[46] and by so voting he or she failed to comply with their duties as a director, the director is jointly and severally liable with all other such directors to reimburse the company the amount by which the value of the distribution exceeded the amount that could have been distributed without contravening the Act.

11.1 Capitalisation shares

Unless expressly prohibited in the Memorandum of Incorporation, a company may issue capitalisation shares for no consideration on a proportionate basis to the shareholders of one or more classes of shares. The board may at the same time allow shareholders to elect instead to receive a cash payment, at a value determined by the board.

11.2 Company or subsidiary acquiring company's shares

A subsidiary of a holding company may acquire no more than ten per cent of the number of any class of shares of a holding company. The acquisition must be authorised by the company's or subsidiary's Memorandum of Incorporation, or in the case of:

- A purchase from one or more individual shareholders, by a special resolution of the shareholders of the company or of its subsidiary.
- A general purchase from all holders of the class of shares concerned, by an ordinary resolution of the shareholders of the company or of its subsidiary.

12 Public security offerings

12.1 Primary and secondary offerings

The Act[47] provides for primary and secondary offering of securities to the public. The following definitions are relevant:

- **An initial public offering**: means an offering to the public of any securities, if no securities of that company have previously been offered to the public.
- **A primary offering**: means an offer to the public of securities to be issued by that company or its subsidiary.
- **A rights offer**: means an offer for subscription, with a right to renounce in favour of other persons, for any securities.
- **A secondary offering**: means an offer to the public of any securities of a company or its subsidiary, made by or on behalf of a person other than that company or its subsidiary.

12.2 Requirements concerning a prospectus

A person must not make an initial public offering unless that offer is accompanied by a document called a ‘prospectus’ that satisfies the requirements of the Act, and has been filed. A prospectus must comply with the specifications of Schedule 3 of the Act. In addition, it must contain all information that an investor may reasonably require to assess a company in which a right or interest is to be acquired, its assets and liabilities, financial position, profits and losses, cash flow and prospects, and the shares and rights attached to them. These requirements do not apply in respect of listed securities, except listed securities that are the subject of an initial public offering.

If securities are offered to the public, every director and promoter of the company and every person who has authorised the issue of the prospectus is liable to pay compensation to any person who has acquired securities on the faith of the prospectus. Compensation will be payable for any loss or damage they may have sustained as a result of any untrue statement in the prospectus.

12.3 Secondary offers to the public

A person making a secondary offering of the securities of a company must attach to that offer either the registered prospectus, or a written statement that satisfies the requirements of the Act.

This requirement does not apply in circumstances where the offer is made by a person acting in the capacity of an executor or administrator of a deceased estate or a trustee of an insolvent estate or a liquidator or trustee referred to in the Agricultural Credit Act[48] or for the purpose of a sale in execution or by public auction or by public tender.

13 Shareholders

13.1 Shareholder right to be represented by proxy

A ‘proxy’ is someone who acts on behalf of another. A shareholder may appoint one or more proxies to participate in and vote at a meeting of shareholders. The appointment must be in writing, and is valid for one year after the date on which it was signed, or any longer or shorter period expressly set out in the appointment.

13.2 Shareholder meetings

A shareholders meeting must elect directors; approve financial statements; receive the remuneration committee report; and appoint auditors.

The board of a company may call a special meeting of shareholders at any time. The board must call a special meeting of shareholders if a written demand for a special meeting is signed by at least 25 per cent of the shares entitled to be voted in respect of the matter proposed to be considered at the meeting. The Memorandum of Incorporation may allow a lower percentage.

If a company fails to convene a special meeting within the time required, a shareholder of the company may apply to court for an order requiring the company to convene the meeting on a date and subject to any terms the court considers appropriate.

13.3 Notice of meetings

A notice of a meeting of shareholders must include the date, time and place for the meeting and the general purpose of the meeting. It must have a reasonably prominent statement that a shareholder entitled to attend and vote at the meeting is entitled to appoint one or more proxies in the place of the shareholder.

13.4 Meeting conduct, quorum and adjournment

A meeting of shareholders may be conducted entirely by electronic communication. Subject to the Memorandum of Incorporation, a meeting of

shareholders may not begin until holders of at least 25 per cent of the shares entitled to be voted in respect of at least one matter to be decided at the meeting are present, and at least 25 per cent of the shares are present at the time the matter is called on the agenda.

13.5 Shareholder resolutions

Every resolution adopted at a meeting of shareholders is either a special resolution, or an ordinary resolution.

For a special resolution to be approved, it must be supported by the holders of at least 75 per cent of the shares voted on the resolution. For an ordinary resolution to be approved, it must be supported by the holders of at least a majority of the shares voted on the resolution.

The Memorandum of Incorporation may allow a smaller percentage of shares, subject to a minimum of 65 per cent, to be voted in support of a special resolution for it to be adopted; or require a larger percentage of shares, subject to a maximum of 60 per cent, to be voted in support of an ordinary resolution for it to be adopted.

A special resolution is required to amend the company's Memorandum of Incorporation; approve the voluntary winding-up of the company; or to approve any other proposal as required by the Act or a company's Memorandum of Incorporation.

14 Board and directors

Every company must have a board of directors, comprising:

- Non-profit company that is not a public interest company: at least three directors.
- Closely held company that is not a public interest company: at least one director.
- Public interest company: at least four directors.

The Memorandum of Incorporation may provide for a higher minimum number of directors. The business and affairs of a company must be managed under the direction of its board. The board has the authority to exercise all of the powers and perform any of the functions of the company, subject to the Memorandum of Incorporation.

14.1 Board meetings

A director authorised by the board of a company may call a meeting of the board at any time, and must call such a meeting if at least two of the directors, or 25 per cent of the directors require it. The Memorandum of Incorporation may require a higher, or permit a lower, number or percentage.

A majority of the directors must be present, in person or by electronic communication, before a vote may be called at a meeting of the directors. Each director has one vote on a matter before the board. A majority of the votes cast on a resolution is sufficient to approve that resolution.

14.2 Board committees

The board may appoint any number of committees of directors, and delegate to any committee any of the authority of the board, subject to any limitation set out in the Memorandum of Incorporation.

14.3 Election and removal of directors

The directors of a company are elected by the holders of shares entitled to be voted in such an election. Subject to the Memorandum of Incorporation, the terms of directors of a public company must be arranged so that the terms of one-third of the directors expire each year.

A director may be removed by a special resolution at a meeting of holders of the shares entitled to be voted in an election of directors.

14.4 Disqualified person may not act as a director

A person who is disqualified must not:

- Be appointed or elected as a director of a company, or consent to such an election or appointment.
- Make, or participate in making any decision that affects the whole, or a substantial part, of a company's business.
- Exercise the capacity to affect significantly a company's financial standing.
- Communicate advice, instructions or wishes to the directors of a company, other than in the proper performance of the person's role as a professional advisor.
- Act in the capacity of a director of a company in any other manner.

A person is disqualified as a director of any company if the person:

- Is a juristic person.
- Has not consented to be a director of that company.
- Is an unemancipated minor, or other person under a legal disability.
- Does not reside in South Africa, unless the company has more than one director and at least one of the other directors does reside in South Africa.
- Is disqualified by, or does not satisfy any qualification set out in, the company's Memorandum of Incorporation.
- A court has prohibited that person to be a director, or declared the person to be a delinquent director in terms of the Act.
- The person is prohibited in terms of any public regulation to be a director of the company.
- Is an unrehabilitated insolvent.
- Has been removed from an office of trust, on the grounds of misconduct.

- Has been convicted and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury, or an offence involving fraud, misrepresentation or dishonesty in connection with the promotion, formation or management of a company, or in connection with any act referred to in the Act, FICA, the Securities Services Act,[49] the Prevention of Corruption Act,[50] or Chapter 2 of the Prevention and Combating of Corrupt Activities Act.[51]

The Memorandum of Incorporation may impose additional grounds of disqualification of directors; or minimum qualifications to be met by directors of that company. Despite being disqualified for non-residency, insolvency, misconduct, or conviction and imprisonment, a person may act as a director of a company if it is a closely held company; and all of the shares of that company are held by that disqualified person, or persons related to that disqualified person.

A disqualification for conviction and imprisonment ends five years after the completion of the sentence imposed for the relevant offence; or at the end of a single extension of not more than 15 years, as determined by the court, on application by the Commission before the expiry of the first five-year period.

14.5 Standards of director's conduct

Each director of a company is subject to:

- A duty to exercise the degree of care, skill and diligence that would be exercised by a reasonably diligent individual who had both:
  - The general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by that director in relation to the company; and
  - The general knowledge, skill and experience of that director; and
- A fiduciary duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company.

Robinson v Randfontein Estates Gold Mining Co Ltd [52]

A mining company held mineral rights over a farm but did not own the land. The company set up a subsidiary company for the sole purpose of buying the farm but this was not successful because of disagreements with the owner. After the owner died, the managing director of the mining company bought the farm from the heirs in his own name, and sold it for three times the price he had paid to the subsidiary company. The managing director then sold all his shares in the mining company and left. The new board of directors sued him for all the profits he made from the sale.

The court laid down the principles regarding the fiduciary duties of any person occupying a position of trust against another whose interests he or she must protect. A person who stands in a position of trust cannot advance his own interests, for example, by making a profit, at the other's expense. The court held the managing director was not entitled to keep the profits and ordered him to repay.

A director's judgement that something is in the best interest of the company is reasonable if the director has taken reasonably diligent steps to become informed about the issue, and does not have a personal financial interest in the issue; and it is a viewpoint that a reasonable individual in a similar position could hold in comparable circumstances.

In addition to the general duty of care, and fiduciary duty, a director must:

- Comply with the Act and the company's Memorandum of Incorporation.
- Communicate to the board at the earliest practicable opportunity any material information that comes to the director's attention, unless the director reasonably believes that the information is generally available to

the public, or known to the other directors; or is bound not to disclose that information by a legal or ethical obligation of confidentiality.

14.6 Director's use of information and conflicting interests

A director must not, directly or indirectly, use that position to make a secret profit or otherwise gain an advantage for the director or someone else; or cause detriment to the company. A director must not improperly use that office to participate in the making of, or attempt to influence, a decision on a matter in respect of which the director has a conflicting personal financial interest.

If a director has a conflicting personal financial interest in respect of a matter to be discussed at a meeting of the board, the director must declare the conflicting interest and its general nature at the meeting; must immediately leave that part of the meeting during which the matter is to be discussed; must not take part in the discussion or vote on the matter or attempt to influence the discussion or vote before, during or after the meeting; and must not execute any document in relation to the matter unless specifically directed to do so by the board.

A transaction between the company and a director in which the director has a personal financial interest (other than a loan or financial assistance), is not void or voidable solely because of that interest, if the transaction was ratified by an ordinary resolution of the shareholders.

14.7 Loans or other financial assistance to directors

A company must not provide a loan or direct or indirect financial assistance to a director of the company, or of a related or inter-related company, unless all the following conditions are satisfied:

- The Memorandum of Incorporation expressly permits giving such financial assistance.
- Any conditions or restrictions respecting the granting of such assistance set out in the Memorandum of Incorporation must be satisfied.
- The board is satisfied that immediately after giving the financial assistance the company would be in compliance with the solvency and

liquidity test, and the terms under which the assistance is proposed to be given are fair and reasonable to the company.

- The financial assistance must be:
  - In terms of an employee share scheme that satisfies the requirements of the Act.
  - In terms of a special resolution of the shareholders.
  - In the case of a closely held company, in terms of a specific authorisation set out in the Memorandum of Incorporation.

A resolution by the board to provide financial assistance is void to the extent that the provision of that assistance would be inconsistent with the Act. Any director who voted in favour of a resolution that is void to any extent is liable to compensate the company or any shareholder for any loss, damages or costs sustained in relation to the transaction.

14.8 Liability of directors and officers

Any provision of an agreement, Memorandum of Incorporation, or resolution of a company, whether express or implied, is void to the extent that it directly or indirectly purports to relieve a director of liability in terms of any gross negligence, wilful misconduct or breach of trust.

A director is liable to the company, and to any other person, for any loss arising from the director having:

- Signed, or agreed to the publication of a financial statement that was false or misleading in a material respect; or a prospectus, or a written statement that contained an untrue statement in a secondary offer to the public, knowing that, or with reckless disregard as to whether, the statement was false, misleading or untrue.
- Knowingly been a party to the reckless carrying on of the company's business; or an act or omission by a company calculated to defraud a creditor, employee or security holder of the company, or with another fraudulent purpose.

15 Financial year of company

A company must have a financial year, which is its accounting period. The first financial year of a company begins on the date that the incorporation of the company is registered and ends on the date not less than three or more than 15 months after the registration date.

16 Accounting records and statements

A company must keep accurate accounting records to present fairly the state of affairs and business of the company, and to explain the transactions and financial position of the business of the company. The records must show its assets, liabilities and equity, as well as its income and expenses, and satisfy the prescribed standards as to form, content, record-keeping procedures, accuracy, and audit and verification requirements.

The annual financial statements must be approved by the board and signed by an authorised director, and presented to the first meeting of shareholders after the statements have been approved.

Annual financial statements must show the remuneration and benefits received by directors, and individuals holding any prescribed office in the company. They must also show the amount of the pensions paid to current or past directors, and any compensation paid in respect of loss of office to current or past directors.

Only public companies, SOCs and other profit or non-profit companies determined by the Minister of Finance must have their annual financial statements audited. The Minister will consider the economic or social significance of the company, as shown from its annual turnover, the size of its workforce or the nature and extent of its activities.

Every company must calculate its ‘public interest score’ for each financial year to determine if it must have its annual financial statements audited, and with which set of financial reporting standards it must comply.

If a profit company's ‘public interest score’ is 350 or more, it must have its annual financial statements audited. The public interest score is determined by four factors: (i) a number of points equal to the average number of its employees during a financial year; (ii) the average amount of its liabilities to third parties at financial year end (one point for every R1 million); (iii) its turnover during the financial year (one point for every R1 million); and (iv) the number of its direct or indirect shareholders who are natural persons at financial year end (one point for every individual).

If a private company is not required to have its annual financial statements audited, then they must be ‘independently reviewed,’ except where every shareholder is also a director of the company. An ‘independent

review’ involves less strict and cheaper examination of financial statements than an audit. In the case of a small company this can be done by someone who is not a practising chartered accountant.[53]

17 The appointment of a company secretary, auditor, audit committee, and social and ethics committee

Only public companies and SOCs must appoint a company secretary and an audit committee. No private or other type of company is obliged to appoint a company secretary or an audit committee, even if it is obliged to have its annual financial statements audited.

Each SOC, listed public company and any other company that has, in any two of its previous five financial years, scored above 500 points on its public interest scorecard (150 points more than the score at which a company is obliged to have its annual financial statements audited) must appoint a social and ethics committee. A company may apply to the Tribunal for an exemption from this requirement.

The social and ethics committee must monitor the company's activities in relation to five aspects of a company's social responsibilities: (i) social and economic development; (ii) good corporate citizenship; (iii) the environment, health and public safety; (iv) consumer relationships; and (v) labour and employment.[54]

17.1 Company secretary

The first company secretary may be appointed either by an ordinary resolution of the shareholders, or the directors of the company. A juristic person or partnership may be appointed to hold the office of secretary.

The duties of company secretary are as follows:

- Provide the directors with guidance as to their duties, responsibilities and powers.
- Make the directors aware of all law and legislation relevant to the company, and reporting at any meetings of the shareholders or directors, any failure to comply with legislation.
- Ensure that minutes of all shareholders' meetings, directors' meetings and the meetings of any committees of the directors are properly

recorded.

- Certify the annual financial statements of the company that it has filed required returns in terms of the Act, and that all returns are true, correct and up to date.
- Ensure that a copy of the company's annual financial statements is sent to every person who is entitled to it.

The name of the company secretary must be stated on every trade catalogue, trade circular and business letter that bears the company's name.

17.2 Audit committee

The board of a public company must appoint an audit committee with at least two members, each of whom must be a director of the company, and act independently in the performance of the committee's functions.

Members of the audit committee must not be involved in the day-to-day management of the business; full-time salaried employees of the company or its group at any time during the previous three financial years; nor related to any full-time salaried employee.

The duties of an audit committee are to nominate a registered auditor who is independent of the company; determine the nature and extent of any non-audit services that the auditor may provide; and deal appropriately with any complaints relating either to the accounting practices and internal audit of the company.

The audit committee must also insert into the financial statements a report describing how the committee carried out its functions, and stating whether or not the committee is satisfied that the auditor was independent of the company.

18 Takeovers, offers and fundamental transactions

A ‘fundamental transaction’ is an arrangement that significantly changes a company due to a fundamental change in its business, securities or shareholders.

The Act[55] provides for the following three types of fundamental transactions:

- The disposal of all, or most, of a company's assets or undertaking.
- A scheme of arrangement between a company and its shareholders.
- An amalgamation or merger that allows any number of companies to agree to merge or amalgamate their respective businesses in nearly any way they want. This flexibility allows for groups of companies to restructure themselves or their businesses internally. The Act allows them to do this quickly and easily.[56]

The same approval procedure is used for all three fundamental transactions. All of them require the prior approval of independent shareholders by way of a special resolution. Approval by a court is only required if at least 15 per cent of independent shareholders' votes are cast against the special resolution and any dissenting minority shareholder requires the company to seek court approval.

The Act gives minority shareholders an ‘appraisal right’ to force the company to buy back their shares at their fair value, and for cash, where its majority shareholders have passed a special resolution to enter into a fundamental transaction.[57]

18.1 Mandatory offers

If a person acquires a beneficial interest in shares of a public company and will be able to exercise 35 per cent or more of the voting rights of that company, within one month after the date of the acquisition they must issue a notice to the holders of the remaining shares offering to acquire any remaining shares on the same terms that applied to the acquisition.

Within three months after receiving the notice, a holder of shares may require the person who gave the notice to buy them.

18.2 Compulsory acquisitions of a public company

If an offer for the acquisition of any class of shares of a public company has been accepted by the holders of at least 90 per cent of that class of shares, the offeror must, within one month, notify the holders of the remaining shares of the class that the offer has been accepted to that extent.

Within three months after receiving this notice, a holder of any remaining shares may demand that the offeror acquire all their shares of the class concerned.

18.3 Proposals for merger or amalgamation

Two or more companies, including holding and subsidiary companies, may amalgamate or merge if, afterwards, each amalgamated or merged company will satisfy the solvency and liquidity test. They must enter into an agreement setting out the terms and means of effecting the amalgamation or merger.

18.4 Proposals for scheme of arrangement

Unless in liquidation or in business rescue, a company may propose and implement any arrangement between the company and its shareholders to reorganise the share capital of the company. This can be done by consolidation of shares of different classes; division of shares into different classes; expropriation of shares from shareholders; share exchange; share repurchase; or any combination of these methods.

18.5 Required approval for certain transactions

Any proposal to dispose of substantially all of the assets or undertaking of the company; implement a merger or an amalgamation; or to implement a scheme of arrangement, must be approved by the shareholders of the company by a resolution adopted at a meeting called for that purpose.

Approval will be required by a court if the holders of at least 15 per cent of the shares that were voted on that resolution voted against its adoption unanimously required the company to seek court approval. Any shareholder who voted against adoption of the resolution may apply to court to review the transaction.

The Takeover Regulation Panel must also give approval if it is an ‘affected transaction’. An affected transaction is one of the following:

- The acquisition of a beneficial interest in any shares of a public company if the acquisition would result in a person able to exercise 35 per cent or more of the voting rights.
- A mandatory offer or a compulsory acquisition.
- A transaction amounting to the disposal of substantially all of the assets or undertaking of a public company.

- A merger or amalgamation involving at least one public company.
- A scheme of arrangement between a public company and its shareholders.

18.6 Effect of amalgamation or merger on legal proceedings

A merger or amalgamation does not affect any existing liability of a party to the agreement to prosecution; civil, criminal or administrative action or proceeding pending; or a judgment in favour of or against an amalgamating or merged company.

19 Business rescue proceedings

One of the most important innovations in the Act is the introduction of a new business rescue regime into South African law. The purpose is to provide a reasonable balance between the interests of a debtor company in financial difficulty and its creditors. The company is given the opportunity to prepare a rescue plan with some protection from action by creditors, and the creditors have a right to vote on the plan.[58]

Only a company that is ‘financially distressed’ can use business rescue proceedings. In looking at its future, a company will be financially distressed if it realises that it may not be able to pay all of its debts as they become due within the next six months. It will also be financially distressed if the likelihood of insolvency is reasonable. In either of these two situations the company can consider using business rescue proceedings.[59]

19.1 Implementation of business rescue proceedings

There are two ways by which business rescue can be implemented. The first is by a resolution adopted by the board of directors to begin rescue proceedings voluntarily. There are strict time periods for the filing of the resolution in order to avoid delays. The directors must believe that the company is financially distressed and that there appears to be a reasonable prospect of the company achieving its goals if a business rescue operation is implemented. Within five business days after filing a business rescue resolution, the directors must appoint a business rescue ‘practitioner’. The company must then file a notice of the practitioner's appointment with the Companies and Intellectual Property Commission (CIPC) within two business days after the appointment, and within five business days after it makes a copy of the notice of appointment available to every creditor, shareholder or registered trade union. The practitioner must be a competent and qualified person and committed to a rescue of the company. The most important duty of the practitioner is to develop a business and rescue plan for the company, in consultation with the stakeholders.

The second way that a business rescue can be implemented is by an ‘affected person’ applying for a court order to place the company under

supervision and commence business rescue proceedings. An affected person is a shareholder or creditor of the company, any registered trade union representing the employees of the company (or the employees themselves if not represented by a trade union). A court may make such an order if it is satisfied that the company is financially distressed, or has failed to pay an amount due in respect of employment-related matters, or it is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect of rescuing the company.

The application to court requests the company to be placed under temporary supervision and request that a business rescue practitioner be appointed to attend to the management of the affairs, business and property of the company. The order also suspends the rights of claimants against the company in respect of the property in its possession. The application must be served on all interested and affected persons. If liquidation proceedings have already started the order will suspend the liquidation proceedings until the business rescue proceedings have ended.

No company may be placed under business rescue, whether by its own board or the court, unless it is a financially distressed company and there is a reasonable prospect of the company being rescued.

19.2 Effect of business rescue proceedings

During business rescue proceedings no legal proceeding may be commenced or continued without the written consent of the business rescue practitioner. Employees continue to remain in employment and all suppliers of goods, services or inputs regarded by the management as essential to the conduct of its business, must continue supplying these to the company on the same terms and conditions. The company may unilaterally cancel or suspend any provision of a contract, except for a contract of employment. An aggrieved party to that contract may claim only for damages. The board and directors of a company must continue to perform and exercise their functions and powers, at the direction of the practitioner.

19.3 Directors of company to cooperate with and assist practitioner

Once business rescue proceedings begin, each director must deliver to the business rescue practitioner all books and records relating to the affairs of the company that are in the director's possession. Within five business days of these proceedings beginning, the directors must provide the supervisor with a statement of affairs containing all of the following information:

- Transactions occurring before the business rescue proceedings began that involved the company or the assets of the company.
- Any court, arbitration or administrative proceedings, including enforcement proceedings, involving the company.
- Assets, liabilities, income and disbursements of the company.
- Employees, and any collective agreements or other employment contracts.
- Debtors and their obligations.
- Creditors and their claims.

A director of a company must provide the practitioner with any information about the company's affairs as may reasonably be required.

19.4 Steps to be taken by business rescue practitioners

The business rescue practitioner must develop a business rescue plan together with the directors and management. This involves an investigation into the company's affairs, business, property and financial situation.

The business rescue plan must specify at least the following information:

- The property available to pay creditors' claims.
- Nature and duration of any moratorium.
- Extent to which the company is to be released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the company, or another company.
- Treatment of contracts and ongoing role of the company.
- Conditions, if any, for the business rescue plan to come into and continue in operation.

- Circumstances in which the business rescue plan will end.
- Order of preference in which the proceeds of property will be applied to pay creditors.
- Effect of the plan on employees.

A business rescue plan must be accompanied by complete financial information.

The business rescue practitioner may suspend, but not cancel, obligations from business contracts. The practitioner must decide whether there is a reasonable prospect of the company being rescued. If this is not achievable, the practitioner must bring an application to court for an order discontinuing the business rescue proceedings and placing the company into liquidation.

If there is evidence of reckless trading, voidable transactions, or breach of duty by the board, the practitioner must direct the management to take steps to rectify the matter. Evidence of fraud must be forwarded to the appropriate authority for investigation and possible prosecution.

Within ten business days of appointment, the practitioner must convene and preside over a first meeting of employees or their representatives to consult with them. At this meeting the supervisor must tell them whether there is a reasonable prospect of rescuing the company. Employees are senior unsecured creditors of the company regarding money that was due and payable before the beginning of the company's business rescue proceedings. Employees are entitled to propose the development of an alternative plan or present an offer to purchase the interests of any or all creditors if the business plan is not adopted.

Also within ten business days after being appointed, the practitioner must convene and preside over the first meeting of creditors and inform the creditors whether there is a reasonable prospect of rescuing the company. During this meeting the practitioner can receive proof of any claims. At the first meeting the practitioner presents a business rescue plan containing information to allow the affected persons to decide whether or not to accept or reject the business plan. Each creditor has the right to vote to amend, approve or reject a proposed business rescue plan. Different voting rights apply to senior unsecured creditors, secured creditors, subordinated creditors, contingent and prospective creditors, and employees who may be retrenched under the proposed plan. If not adopted, each creditor has a

further right to propose the development of an alternative plan or present an offer to purchase the interests of any or all of the other creditors. The creditors of a company are entitled to form a creditors' committee to be consulted by the supervisor during the development of the business rescue plan.

After this the practitioner must convene a second meeting of creditors as well as a meeting with shareholders to consider the business plan. Each shareholder has the right to vote to amend, approve or reject a proposed business rescue plan. If not adopted, each shareholder has a further right to propose the development of an alternative plan or present an offer to purchase the interests of any or all of the other creditors.

A business plan can only be approved if supported by creditors. If the proposed business plan is opposed by the holders of more than 50 per cent of the voting interests or by more than 25 per cent of the independent creditors' voting interests, the plan has failed to be adopted. If the plan affects the interests of any class of shareholders, the practitioner must immediately hold a meeting of the class, or classes of shareholders affected by the plan, and call for a vote by those shareholders to approve the adoption of the proposed business rescue plan.

A business rescue plan that has been adopted is binding on the company, and on each of the creditors and shareholders of the company.

The practitioner must then file a notice of substantial implementation of the business rescue plan.

Business rescue should be completed within three months. However, the court can extend this time. Business rescue proceedings will end when the court either sets aside either the resolution adopted by the board of directors or the court order that began the proceedings; the proceedings are converted to liquidation proceedings; the practitioner has filed a notice of termination of business rescue proceedings; or the business rescue plan has been rejected.

19.5 Failure to adopt business rescue plan

If a business rescue plan is not adopted the business rescue practitioner may seek a vote of approval from the holders of voting interests to prepare and publish a revised plan; or advise the meeting that the company will apply to

the court to set aside the result of the vote by the holders of voting interests or shareholders on the grounds that it was inappropriate or irrational.

If the practitioner does not take such action, any affected person may make a binding offer to purchase the voting interests of any person who opposed adoption of the business rescue plan, at a value that the practitioner determines to be the probable return to that person if the company were to be liquidated.

If no person takes such action the practitioner must promptly file with the Commission a Notice of the Termination of Business Rescue Proceedings.

19.6 Discharge of debts and claims

Creditors and other holders of voting interests who have not participated in the business rescue proceedings are not entitled to enforce any debt that arose before those proceedings began, unless the business rescue plan is not approved or is not yet implemented.

20 Remedies and enforcement

The Act[60] provides for several avenues to address alleged contraventions or to enforce any provision of a company's Memorandum of Incorporation or rules:

- Alternative dispute resolution.
- Arbitration through the Companies Ombud.
- The High Court.
- The Takeover Regulation Panel or the Commission.

20.1 Protection for whistle-blowers

A person who has reasonable grounds to suspect that the company or any of its directors or employees may have contravened any legislation in a manner that is inherently prejudicial to the interests of the company, and in good faith discloses information concerning that suspicion, is immune from any civil or criminal liability for that disclosure unless the disclosure was made anonymously.

A person who has made such disclosure has qualified privilege in respect of the disclosure. A whistle-blower is entitled to compensation for any damages suffered if, because of the disclosure, someone engages in conduct with the intent to cause detriment to him or her.

20.2 Specific remedies

20.2.1 Application to declare or protect shareholders' rights

A shareholder of a company may apply to a court for a declaratory order determining any rights of the shareholder in terms of the Act, the company's Memorandum of Incorporation, or any rules of the company.

20.2.2 Application to declare director delinquent or under probation

The court may make an order declaring a person to be a delinquent director for the lifetime of the person if he or she acted as a director while disqualified in terms of the Act; or acted as a director in a manner that contravened a court order of probation in terms of the Act.

The court may make an order declaring a person to be a delinquent director for seven or more years if he or she:

- Grossly abused the position of director.
- Took personal advantage of information or an opportunity, contrary to the Act.
- Intentionally, or by gross negligence, inflicted harm upon the company.
- Acted in a manner that amounted to gross negligence, willful misconduct or breach of trust.
- Has repeatedly been personally subject to a compliance notice for substantially similar contraventions of the Act.
- Has at least twice been personally subject to an administrative fine for failure to carry out the requirements of a compliance notice in terms of the Act.
- Within a period of five years was a director of one or more companies that were subject to an administrative fine in terms of the Act.

The court may make an order placing a person under probation for a maximum of five years, if while serving as a director he or she:

- Improperly supported a resolution despite the inability of the company to satisfy the solvency and liquidity test.
- Acted in a manner inconsistent with the duties of a director.
- Supported a decision of the company to act in a manner that was oppressive or unfairly prejudicial to, or that unfairly disregarded the interests of, a shareholder, creditor or director of a company.
- Within any period of ten years, has been a director of more companies which during that period have failed to fully pay all of their creditors or meet all of their obligations, except under a business rescue plan.

The Commission must establish and maintain a public registry of persons who are subject to a court order of delinquency or probation.

20.2.3 Relief from oppressive or prejudicial conduct

A shareholder, creditor or director of a company may apply to a court for relief if the conduct of the company has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.

20.2.4 Dissenting shareholders' appraisal rights

A notice to shareholders of a meeting to consider adopting a resolution for any of the following must include a statement informing shareholders of their rights:

- Amend its Memorandum of Incorporation in any manner adverse to the rights or interests of holders of any class of shares.
- Enter into a compulsory acquisition.
- Dispose of substantially all assets or undertaking.
- Enter into a merger or amalgamation.

A holder of shares of any class of a company may demand that the company pay the shareholder the fair value for those shares if the resolution was supported by less than 75 per cent of the shares entitled to be voted, and the shareholder voted those shares in opposition to that resolution and has complied with the procedural requirements of the Act. A shareholder who has made such a demand may apply to court to determine a fair value of the shares.

20.2.5 Class actions and derivative actions

The Act[61] allows legal action to be taken by anyone as a member of or in the interests of a group or class of affected persons. ‘Class actions’ allow people to take legal action collectively.

Minority shareholders may find it difficult to force a company to claim compensation from its directors personally for a breach of their duties. The Act also allows for a ‘derivative action’ to be taken against anyone who has harmed, or may harm, the company's legal interests.[62]

The complainant no longer has to apply to court. Instead, all that the complainant must do is serve a written notice on the company demanding that it institutes legal proceedings against the alleged wrongdoer. Unless the claim is frivolous, vexatious or wholly without merit, the board is then

obliged, at the company's cost, to appoint an independent person or committee to investigate the demand and report back to it on its likely success. After considering the report, the board must either start legal proceedings against the alleged wrongdoer or inform the complainant why it will not do so. The complainant may then apply to court for permission to sue the alleged wrongdoer directly.[63]

20.3 Alternative dispute resolution

As an alternative to applying for relief to a court, or filing a complaint with the Companies and Intellectual Property Commission (CIPC) or the Takeover Regulation Panel, a complainant may refer a matter to the Companies Tribunal, or an accredited entity for resolution by mediation, conciliation or arbitration.

20.4 Complaints to the Companies and Intellectual Property Commission or the Takeover Regulation Panel

Typically an inspector or investigator may investigate the complaint, after which a compliance notice may be issued or the matter may be referred to the National Prosecuting Authority if it is alleged that a person has committed an offence.

A compliance order may be issued against a company, or against an individual if the contravention of the Act was by that individual, or if the Act holds them equally liable with a company for the contravention.

A person who has been issued a compliance notice may challenge it in court, but failing that, is obliged to satisfy the conditions of the notice. If they fail to do so, the Companies and Intellectual Property Commission may either apply to the court for an administrative fine, or refer the failure to the National Prosecuting Authority as an offence.

A court may impose an administrative fine for failure to comply with a compliance notice. The maximum fine may not be more than the greater of ten per cent of the respondent's annual turnover during the preceding financial year, or R1 million.

The court must consider the following factors:

- The nature, duration, gravity and extent of the contravention.
- Any loss or damage suffered as a result of the contravention.
- The behaviour of the respondent.
- The market circumstances in which the contravention took place.
- The level of profit derived from the contravention.
- The degree to which the respondent has cooperated with the Companies and Intellectual Property Commission or Takeover Regulation Panel, and the court.
- Previous contraventions of the Act.

In the case of a company that has failed to comply, been fined, and continues to contravene the Act,[64] the Companies and Intellectual Property Commission may apply to the court for an order dissolving the company.

It is an offence, punishable by a fine or up to ten years' imprisonment, for a director to sign or agree to a false or misleading financial statement or prospectus, or to be reckless in the conduct of a company's business.

21 Offences and penalties

Any person convicted of any the following offences is liable to a fine or to imprisonment for a period of not more than ten years, or to both.

21.1 Breach of confidence

It is an offence to disclose any confidential information concerning the affairs of any person obtained as a result of initiating a complaint, or participating in any proceedings in terms of the Act.[65]

21.2 Reckless conduct and non-compliance

A person is guilty of an offence if the person:

- Signed, or consented to the publication of a financial statement that was false or misleading in a material respect; or a prospectus, or an untrue statement in a public security offering with reckless disregard as to whether the statement was false, misleading or untrue; or
- Was knowingly a party to the reckless carrying on of a business; or an act or omission by a business calculated to defraud a creditor, employee or security holder of the company, or with another fraudulent purpose.

21.3 Hindering administration of Act

Any person convicted of any the following offences is liable to a fine or to imprisonment for a period of not more than 12 years, or to both. It is an offence to hinder, oppose, obstruct or unduly influence a regulatory authority, an inspector or investigator, or a court when any of them is exercising a power or performing a duty conferred by the Act. A person commits an offence who:

- Anticipates any findings of a regulatory authority, an inspector or investigator in a way that is calculated to improperly influence the proceedings or findings.
- Does anything in connection with an investigation or hearing that would have been contempt of court if the proceedings had occurred in a court

of law.

- Refuses to attend when summoned, or after attending, refuses to answer any question or produce any document as required by the summons.
- Knowingly provides false information to a regulatory authority, an inspector or investigator.
- Improperly frustrates or impedes the execution of a warrant to enter and search, or attempts to do so.
- Acts contrary to or in excess of a warrant to enter and search.
- Without authority, but claiming to have authority, enters or searches premises or attaches or removes an article or document.

A person convicted of failing to satisfy a compliance notice is liable to a fine or to imprisonment for a period of not more than 12 years.

PRACTICALLY SPEAKING

Contract drafting tips[66]

Two of the biggest causes of contractual disputes are the failure to address all possible situations, whether deliberately or not, and ambiguity in the provisions that are included. It is important to review a draft contract many times over to avoid these problems. Leaving key items (for example, price or delivery dates) open for later discussion may result in a signed contract being unenforceable. Similarly, not addressing all possibilities, even the unlikely ones, can lead to problems. A provision that is ambiguous can lead to arguments, especially where each side interprets the clause in its favor.

These problems are why it is vital to put the contract in writing. Even though verbal agreements are valid, there can be huge problems to prove the terms are what the parties thought they meant. This is also a good reason for using plain English and avoiding legal jargon. Simply put, if you are not sure what a clause means, then it may be problematic to get the court to understand what it means as well. Using someone else's draft agreement can also be difficult if that contract has provisions that do not apply to your situation or does not address the same issues you face. Experienced lawyers and businesspeople also know that a form contract will change over time as business conditions change and you gain more experience in the issues that will typically arise.

Letters of intent are especially difficult: sometimes it is impossible to prove that they are binding without having to prove the subjective intention of the parties. It is always best to state expressly in each letter of intent whether it is binding or merely a starting point for further discussions.

Some worthwhile clauses to include in a typical contract include the following:

Performance

Be sure to specify exactly what each party must do and when they must do it by. If there is any kind of open-ended commitment, such as a simple fee per month consulting arrangement, then it is useful to specify the maximum and minimum numbers of hours that will be provided.

State exactly when payment is due and what happens if payment is not made on time. If you are the party receiving payment, think about whether to add a fee for late payments, or interest for overdue accounts. Where you are receiving a percentage of the fee, it is prudent to include a provision allowing an audit of the accounts. If VAT or other taxes are involved, specify who pays the taxes.

Competition

In situations where there is concern about access to your confidential information, you should consider including confidentiality provisions to prohibit anyone from sharing the information with others, and also from using confidential information for purposes other than those set out in the contract. Be very careful of provisions that prohibit competition: in South Africa and in many other parts of the world such provisions may be void or may carry criminal penalties.

Termination

If you are buying goods or services, it is always useful to include a termination provision to provide you with protection if the contractual relationship is not working well. Ideally, termination should be allowed at any time upon giving the required notice. Typically a contract may provide for 90 days. Be cautious of provisions that allow termination only once a year during a window period, or for termination on payment of a huge penalty. Think carefully about why you would want to enter into an agreement with a party that insists on including such a provision in a contract. You should also consider including terms relating to your relationship after the contract is terminated: consider whether certain provisions relating to confidentiality, restraints, and outstanding payments, will remain effective beyond the termination date of the main agreement.

Exposure

Any party providing goods or services needs to consider adding provisions that limit warranties. With contracts involving goods, the Uniform Commercial Code automatically creates certain warranties unless there are specific disclaimers of those warranties. Some of these warranties – such as the warranty of fitness for the buyer's purpose – may be difficult for the seller to meet. Warranties can also be a problem for parties providing services. In addition, a party providing services or goods may want to include a provision limiting liability so that there is no exposure for the other side's lost profits etc. in the event of a problem.

Changes

Provisions that restrict amendments to agreements can be useful. For example, unless the contract states otherwise, either side has the right to assign the rights and obligations under the contract. You may want to prevent assignment to a competitor or prevent all assignment so that you are assured of the person with whom you will be dealing. Similarly, it is common to allow assignment to parent or sister companies or to a new version of the same entity, for example when a partnership becomes a corporation.

Generally, any ambiguity in an agreement is construed against the party drafting it. One possible solution is to add a provision stating that the agreement will be interpreted as if drafted by both parties equally. Headings and the recitals at the beginning of an agreement (often the ‘whereas…’ clauses), can be interpreted by courts to give meaning to the contract, so it may be useful to state specifically that such interpretation should not be applied.

Another useful provision is an integration clause. This states that the contract sets out the entire agreement between the parties and that no oral representations or earlier versions of the contract apply. Obviously, this can prevent dispute by limiting the agreement to the terms of the contract itself. Similarly, it is useful to include a provision stating that any modifications of the agreement must be in writing and signed by both parties, to eliminate any future claim that there was an oral modification to an agreement that you dispute.

Enforcement

If you believe it is more likely that you will be a plaintiff and sue over the contract, rather than be a defendant being sued, you could include a provision allowing recovery of attorneys' fees and disbursements on an ‘attorney-and-own-client’ basis. This means that the winning party will be able to recover their full costs, not just the amounts set out in the applicable tariff.

Particularly where the two parties are from different provinces or countries, it is important to specify which country's law will apply and where any litigation will be conducted. Smaller parties in particular will want litigation brought where they are located because of the expense of long-distance litigation. Obviously, this type of provision can generate some argument. One way to resolve disputes over it is to state that the plaintiff has to sue where the defendant is located. However, this is not appropriate for all agreements.

Arbitration clauses may be a suitable alternative. Arbitration may be cheaper and quicker than litigation; however, this is not always true. Arbitration is useful in a small industry or where the parties are likely to be doing business again in the future.

Mediation is another option that can be considered, with or without an arbitration clause. The advantage is that most mediated cases settle. The disadvantage is that if the matter does not settle, you still have the cost of arbitration or litigation.

THIS CHAPTER IN ESSENCE

1 A corporation is a separate legal entity distinct from its shareholders or members.
2 Shareholders or members in a corporation enjoy limited liability. This means that the liability of a shareholder of a company is limited either to the amount unpaid on shares held by that shareholder, or to an amount that that shareholder may have undertaken to contribute to the assets of the company in the event of it being wound up.
3 A corporation has perpetual succession, which means it continues to exist until it is wound up or dissolved, even if all the original members of the corporation have changed or ceased to exist.
4 The scope of authority that an agent of a company may possess differs from one company to another and usually is laid down in the Memorandum of Incorporation. If the Memorandum of Incorporation limits the power or authority that an agent may possess, any outsider is deemed to be aware of this limitation and by law is prevented from relying on this lack of authority in any court action.
5 The Turquand Rule states that when a third party enters into a contract with a company there is a legal presumption that all acts of the company's internal management have been properly carried out and the company will be bound to the contract even if it is proved that the necessary acts of internal management were not carried out, or were irregular or defective, or that the representative of the company had no authority to bind the company.
6 The purposes of the Companies Act are to provide for the incorporation, registration, capitalisation, organisation and management of companies.
7 An individual is related to a juristic person if that individual directly or indirectly controls the juristic person. Two companies are related if either of them controls part of the business of the other; or one of them is a subsidiary of the other.

8 A person controls a juristic person, or all or part of its business, if the first person, directly or indirectly, has the power to determine substantially the policy and direction of the juristic person or its business.

9 A juristic person is a subsidiary of another juristic person if more than 50 per cent of its shares are held by another juristic person, or by one or more of its wholly owned subsidiaries, or by their respective nominees.

10 A profit company is incorporated by one or more persons for the purpose of financial gain for its shareholders. It may be a private company; public company; State-owned company; or a personal liability company.

11 A non-profit company is owned by members, and incorporated for a public benefit or a purpose related to social or cultural activities, or communal or group interests. To identify it as a non-profit company, its name must end with the abbreviation ‘NPC’.

12 A company is a juristic person with a legal identity created on registration through a process known as incorporation. It continues in existence until its name is removed from the Companies Register.

13 A company may be dissolved by voluntary winding-up by the company itself, or by creditors, or winding-up and liquidation by court order.

14 A company must satisfy the solvency and liquidity test to provide protection to creditors. The company's total assets exceed its total liabilities, and it must appear that the company will be able to pay its debts as they became due for the next 12 months.

15 A share represents one unit of ownership in a company. A share certificate issued by a company is movable property.

16 A shareholders meeting must elect directors; approve financial statements; receive the remuneration committee report; and appoint auditors.

17 Every resolution adopted at a meeting of shareholders is either a special resolution, or an ordinary resolution. For a special resolution to be approved, it must be supported by the holders

of at least 75 per cent of the shares voted on the resolution. For an ordinary resolution to be approved, it must be supported by the holders of at least a majority of the shares voted on the resolution.

18 Every company must have a board of directors. A disqualified person may not act as a director.

19 Each director of a company has a duty to exercise the degree of care, skill and diligence that would be exercised by a reasonably diligent individual, and a fiduciary duty to act honestly and in good faith, and in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company. A director must not, directly or indirectly, use that position to make a secret profit or otherwise gain an advantage or cause detriment to the company.

20 A company must keep accurate accounting records to present fairly the state of affairs and business of the company, and to explain the transactions and financial position of the business of the company.

21 Only public companies and State-owned companies must appoint a company secretary and an audit committee.

22 A fundamental transaction is an arrangement that significantly changes a company due to a fundamental change in its business, securities or shareholders. It may be the disposal of all, or most, of a company's assets or undertaking; a scheme of arrangement between a company and its shareholders; or an amalgamation or merger.

23 Only a company that is financially distressed can use business rescue proceedings if it realises that it may not be able to pay all of its debts as they become due within the next six months, or if the likelihood of insolvency is reasonable.

24 The board of directors may decide to begin rescue proceedings voluntarily, or an affected person may apply for a court order to place the company under supervision and commence business rescue proceedings.

25 During business rescue proceedings no legal proceeding may be commenced or continued without the written consent of the business rescue practitioner. The company may unilaterally

cancel or suspend any provision of a contract, except for a contract of employment. An aggrieved party to that contract may claim only for damages.

26 The Act allows legal action to be taken by anyone as a member of or in the interests of a group or class of affected persons. Class actions allow people to take legal action collectively.

QUESTIONS

Short questions (1–5 marks)

1. List ten differences between a partnership and a corporation.
2. Name five purposes of the Companies Act.
3. Distinguish between a profit company, and a not-for-profit company.
4. List five shareholder rights.
5. List eight reasons for which a person may be disqualified from serving as a director.
6. List the two standards of conduct with which every director of a company must comply.

Paragraph questions (5 marks)

1 Discuss three important attributes of companies and how these attributes distinguish a corporation from a natural person.

2 Describe the process of company incorporation and registration.

3 Discuss what is meant by a pre-incorporation contract.

4 Discuss the process of voluntary winding-up.

5 Outline how a company may give financial assistance for the purchase of its own shares.

6 What is the solvency and liquidity test?

7 Define what is meant by a debenture.

8 What is an audit committee, and how does it operate?

9 Distinguish between a mandatory offer and a compulsory acquisition.

10 List five remedies that an aggrieved person may take to remedy a situation under the Companies Act.

11 What is the effect of a compliance order issued by the Takeover Regulation Panel?

Essay questions (10 marks)

1. Discuss the importance of the Turquand Rule.
2. Distinguish between an amalgamation and a merger.
3. What is meant by a business rescue and how does it operate?

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1 Financial Intelligence Centre Act 38 of 2001; Securities Services Act 36 of 2004; Auditing Profession Act 26 of 2005; National Credit Act 34 of 2005; Corporate Laws Amendment Act 24 of 2006; Companies Act 71 of 2008.

2 Stein, C, *The Most Significant Changes to South Africa's Company Laws Brought about by the Companies Act, 2008*, Johannesburg: Bowman Gilfillan 2010.

3 Gibson, 267–272.

4 *Webb and Company Ltd v Northern Rifles* 1908 TS 462; *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 550.

5 Investment Vehicles, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

6 *Salomon v Salomon and Co Ltd* 1879 AC 22.

7 Ibid.

8 *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 550.

9 *Madrassa Anjuman Islamia v Johannesburg Municipal Council* 1919 AD 439; *Ex parte Donaldson* 1947 (3) SA 170 (T); *Universiteit van Pretoria v Tommie Meyer Films (Edms) Bpk* 1977 (4) SA 376 (T), 1979 (1) SA 441 (A); *Dean v John Menzies (Holdings) Ltd* 1981 SLT 50; *Caxton Ltd v Reeva Forman (Pty) Ltd* 1990 (3) SA 547 (A); *Sage Holdings Ltd v Financial Mail (Pty) Ltd* 1991 (2) SA 117 (W).

10 Companies, *Doing Business in South Africa*, Sandton: Deneys Reitz Attorneys March 2005.

11 *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 548 (A).

12 *Estate Salzman v Van Rooyen* 1944 OPD 1.

13 *British Thomson-Houston Co Ltd v Sterling Accessories Ltd* 1924 (2) Ch 33; *Barkett v SA Mutual Trust and Assurance Co Ltd* 1951 (2) SA 353 (A).

14 *Leonards Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705 (HL); *Yates Investments (Pty) Ltd v Commissioner for Inland Revenue* 1956 (1) SA 364 (A).

15 *R v Gillet* 1929 AD 364.

16 *Re Darby* 1911 1 KB 95; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Orkin Bros Limited v Bell* 1921 TPD 92.

17 *Gilford Motors Co Ltd v Horne* 1933 Ch 935; *Cattle Breeders Farm (Pvt) Ltd v Veldman* 1974 (1) SA 169 (RA).

18 *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* 1916 (2) AC 307.

19 Gibson, 271.

20 *Webb and Company Ltd v Northern Rifles* 1908 TS 462.

21 Close Corporations Act 69 of 1984.

22 Investment Vehicles, *Investing in South Africa*, Johannesburg: Webber Wentzel Bowens, April 2005.

23 Companies Act 71 of 2008.

24 Close Corporations Act 69 of 1984.

25 *Royal British Bank v Turquand* (1856) 6 E & B 327, 119 ER 886.

26 Beuthin and Luiz, 214–215.

27 *SAIF Co-operative Society v Webber* 1922 TPD 49; *The Mineworkers' Union v JJ Prinsloo* 1948 (3) SA 831 (A); *National and Overseas Distributors Corporation (Pty) Ltd v Potato Board* 1958 (2) SA 473 (A); *Tuckers Land and Development Corporation (Pty) Ltd v Perpellief* 1978 (2) SA 11 (T).

28 *Mbana v Mnquma Municipality* 2004 (1) BCLR 83 (Tk); *FPW Engineering Solution (Pty) Ltd v Technikon Pretoria and others* [2004] 1 All SA 204 (T); Tshiki, P, The Turquand rule vs the doctrine of ultra vires, *De Rebus*, Pretoria: Law Society of South Africa.

29 *Hoisain v Town Clerk, Wynberg* 1916 AD 236; *Potchefstroomse Stadsraad v Kotze* 1960 (3) SA 616 (A); *Holgate v Minister of Justice* 1995 (3) SA 921 (E).

30 *Potchefstroom se Stadsraad v Kotze* 1960 (3) SA 616 (A).

31 Companies Act 71 of 2008.

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48 Agricultural Credit Act 28 of 1966.

49 Securities Services Act 36 of 2004.

50 Prevention of Corruption Act 6 of 1958.

51 Prevention and Combating of Corrupt Activities Act 12 of 2004.

52 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

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55 Companies Act 71 of 2008.

56 Stein, C, *The Most Significant Changes to South Africa's Company Laws Brought about by the Companies Act, 2008*, Johannesburg: Bowman Gilfillan 2010.

57 Ibid.

58 Katz, M, A practical guide to the implications of the new Companies Act (9) – practical implications of the new business rescue regime in terms of chapter 6 of the new Act, *De Rebus*, Pretoria: Law Society of South Africa, November 2011.

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60 Companies Act 71 of 2008.

61 Companies Act 71 of 2008.

62 Stein, C, *The Most Significant Changes to South Africa's Company Laws Brought about by the Companies Act, 2008*, Johannesburg: Bowman Gilfillan 2010.

63 Ibid.

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PART F: BUSINESS CONDUCT

What is the right way for me to run my business?

CHAPTER 28 Corporate governance and insider trading – *Running the business in an open and transparent way*

CHAPTER 29 Black Economic Empowerment – *Increasing the number of black South Africans who own, run and control businesses*

CHAPTER 30 Consumer protection – *Protecting people who buy from me*

CHAPTER 31 Insolvency – *What can I do when someone does not pay me?*

Chapter 28

Corporate governance and insider trading

'In law a man is guilty when he violates the rights of others. In ethics he is guilty if he only thinks of doing so.'

IMMANUEL KANT (1724–1804)
GERMAN PHILOSOPHER, ONE OF THE FOREMOST THINKERS OF THE ENLIGHTENMENT

What is covered in this chapter

1 What is corporate governance?

2 The *Third King Code of Governance for South Africa 2009* (King III)

3 Compliance and enforcement of King III

4 Insider trading

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

The Global Financial Crisis of 2010 proved that the way that corporations are governed can affect us all. In the same way that failure to comply with internal controls and regulations can lead to devastating consequences, companies that raise standards of conduct can improve the lives of people.

Compliance with the *Third King Code of Governance for South Africa 2009* can result in improved fairness, accountability, responsibility, and transparency. The level of this disclosure will allow stakeholders to get better insight into the quality of decisions made by boards of directors.

Mervyn King, Chairperson of the King Committee on Corporate Governance in South Africa, said the following about the importance of corporate governance:[1]

> **'It is estimated that of the 100 largest economies in the world by gross revenue, 51 are multinational companies and only 49 are governments. The impact that these great multinational companies have on the earth is huge. Companies are far greater agents for change than governments, if for no other reason than there are millions of companies in the world and only a few hundred governments. They have a duty to their stakeholders to act and to be seen to be acting as good corporate citizens. Governance of companies has consequently become of critical importance in the twenty-first century….'**

1 What is corporate governance?

Directors and officers are required by law to comply with their legal duties, namely the duty of care, skill, and diligence, and fiduciary duties. Corporate governance involves creating structures and processes with checks and balances to enable directors to discharge their legal responsibilities and to oversee compliance with legislation.

Corporate governance practices, codes, and guidelines raise the level of appropriate standards of conduct. Failure to meet a recognised standard of governance, even if not legislated, may in some cases render a board or individual director liable.

Governance of corporations can be regulated in one of two ways:

- Compulsory through legislation (such as in the United States). This has been criticised because costs, focus, and time spent in compliance may be better used in growing the business.
- Voluntary application of a code of principles and practices (such as in South Africa and Europe).

The *First King Report on Corporate Governance* was published in 1994 by the Institute of Directors in response to the increasing concern over corporate failures and the perceived need for a formal code of corporate governance. It sought to assist companies and their directors by providing a comprehensive set of principles and guidelines to codify, clarify and, in certain circumstances, expand upon the common-law principles of corporate governance. The *Second King Report* was finalised in March 2002 and both reviewed and expanded on the First Report.[2]

The *Third King Code of Governance for South Africa 2009* (commonly known as King III) is a largely voluntary code that applies to all corporations, whether in the public, private or non-profit sectors, from 1 March 2010. It is considered voluntary in that the board of directors may decide not to follow a recommendation in King III. They may decide to apply it differently or to apply another practice. Their explanation of how

they applied King III principles and recommendations, or their reasons for not applying the principles, results in compliance with broader corporate governance values of fairness, accountability, responsibility, and transparency. The level of this disclosure will allow stakeholders to comment on and challenge the board on the quality of its governance.[3]

2 The *Third King Code of Governance for South Africa 2009* (King III)

There are nine elements set out below.

2.1 Ethical leadership and corporate citizenship

The board should provide effective leadership based on an ethical foundation. Ethical leaders should direct the strategy and operations to build a sustainable business. They must consider the short-term and long-term impacts of the strategy on the economy, society, and the environment, and they should do business ethically. They should take account of the company's impact on internal and external stakeholders. The board should set the values to which the company will adhere, and ensure that its conduct in all aspects of business and that of management aligns to these values. The board must also ensure that each director performs the duties required. The board should ensure that all actions are based on the four values underpinning good governance, namely responsibility, accountability, fairness and transparency, and that each director complies with the duties of a director.

King Code of Governance for South Africa 2009

'The ethics of corporate governance requires all deliberations, decision and actions of the board and executive management to be based on the following four ethical values underpinning good corporate governance:[4]

1. **Responsibility: The board should assume responsibility for the assets and actions of the company and be willing to take corrective actions to keep the company on a strategic path that is ethical and sustainable.**
2. **Accountability: The board should be able to justify its decisions and actions to shareholders and other stakeholders.**
3. **Fairness: The board should ensure that it gives fair consideration to the legitimate interests and expectations of all stakeholders of the company.**

4. **Transparency: The board should disclose information in a manner that enables stakeholders to make an informed analysis of the company's performance, and sustainability.'**

The board should ensure that the company is and is seen to be a responsible corporate citizen. In addition to financial performance, the board should consider the impact of the company's operations on society and the environment. It should ensure that the company's performance and interaction with its stakeholders are guided by the Constitution and the Bill of Rights, and that management develops corporate citizenship policies.

The board should ensure that the company's ethics are managed effectively. The board should also ensure that it builds and sustains an ethical corporate culture in the company. Ethical risks and opportunities should be incorporated in the risk-management process, and the company's ethics performance should be assessed, monitored, reported, and disclosed.

2.2 Boards and directors

The board is the custodian of corporate governance. It should have a charter setting out its responsibilities and meet at least four times per year. It should monitor the relationship between management and the stakeholders of the company to ensure that the company grows.

The board should approve business strategy and should ensure alignment with the purpose of the company, the value drivers of its business, and the legitimate interests and expectations of its stakeholders. The board should satisfy itself that management has thoroughly examined risks and that the strategy will result in sustainable outcomes taking account of people, planet, and profit.

The board and its directors should act in the best interests of the company. Directors must comply with the legal standards of conduct. Directors or the board should be allowed to take independent advice in connection with their duties following an agreed procedure. Real or perceived conflicts should be disclosed to the board and managed. Listed companies should have a policy regarding dealing in securities by directors, officers, and selected employees.

The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as

defined in the Companies Act.[5] It should ensure that the solvency and liquidity of the company is continuously monitored. If it offers to save a financially distressed company either by way of workouts, sale, merger, amalgamation, compromise with creditors, or business rescue, it must ensure that its consideration is fair, that a suitable practitioner is appointed if business rescue is adopted, and that the practitioner furnishes security for the value of the assets of the company.

The board should elect a chairperson of the board who is an independent non-executive director, and is responsible for the effective functioning of the board. The functions of the chairperson include the following:

- Leadership of the board.
- Participating in the selection of board members and monitoring director appraisals.
- Formulating an annual work plan for the board.
- Acting as a link between the board and management.
- Maintaining relationships with shareholders.

Members of the board should elect a chairperson annually. The chairperson should be independent and free of conflict on appointment. The role of the chairperson should be formalised. The chairperson's ability to add value, and his or her performance against what is expected of his or her role and function, should be assessed every year. The board should ensure a succession plan for the role of the chairperson. The board should appoint the chief executive officer, establish a framework for the delegation of authority, and ensure that succession planning for the Chief Executive Officer (CEO) and other senior executives and officers is in place.

The CEO of the company should not fulfil the role of chairperson of the board as well – there should be a clear distinction between these two roles. The CEO's job is to run the business and to implement the policies and strategies adopted by the board.

A director of the board may serve as follows:

- As an executive director who may be an employee and is involved in the day-to-day running of the business.
- As a non-executive director who is not an employee and is not involved in the day-to-day running of the business.

- As a non-executive, independent director who is not a representative of a shareholder, has not been employed by the company in an executive capacity in the previous three financial years, and has no significant contractual relationship or interest in the company.

The board should have a balance of power, with a majority of non-executive directors. The majority of non-executive directors should be independent. When determining the number of directors serving on the board, the knowledge, skills, and resources required for conducting the business of the board should be considered.

Every board should consider whether its size, diversity, and demographics make it effective. Every board should have a minimum of two executive directors of which one should be the CEO and the other the director responsible for finance. At least one-third of the non-executive directors should rotate every year. The board should be permitted to remove any director without shareholder approval.

- Directors should be appointed through a formal process, including a nomination committee, background and reference checks, and a letter of appointment. The induction of and ongoing training and development of directors should be conducted through formal processes, including the following:
- A formal induction programme for new directors.
- Development of inexperienced directors through mentorship programmes.
- Continuing professional development programmes.
- Regular briefings on changes in risks, laws, and the environment.

The board should be assisted by a competent, suitably qualified, and experienced company secretary, who should not be a director of the company. His or her functions include the following:

- Assist the nominations committee with the appointment of directors and director induction and training programmes.
- Provide guidance to the board on the duties of the directors and good governance.
- Ensure board and committee charters are kept up to date.
- Prepare and circulate board papers.

- Elicit responses, input, and feedback for board and board committee meetings.
- Assist in drafting yearly work plans.
- Ensure preparation and circulation of minutes of board and committee meetings.
- Assist with the evaluation of the board, committees, and individual directors.

Evaluation of the board, its committees, and the individual directors should be performed every year. An overview of the appraisal process, results, and action plans should be disclosed in the integrated report. The nomination for the reappointment of a director should occur only after evaluation of the performance and attendance of the director.

The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities. Committees' terms of reference should be reviewed yearly. Public and State-owned companies must appoint an audit committee. All other companies should establish an audit committee and define its composition, purpose, and duties in the Memorandum of Incorporation. Companies should establish risk, nomination, and remuneration committees. Committees, other than the risk committee, should comprise a majority of non-executive directors of which the majority should be independent.

Listed subsidiaries must comply with the rules of the relevant stock exchange in respect of insider trading.

Companies should remunerate directors and executives fairly and responsibly according to remuneration policies aligned with the strategy of the company and linked to individual performance. The remuneration policy should address base pay and bonuses, employee contracts, severance and retirement benefits, and share-based and other long-term incentive schemes. Companies should disclose the remuneration of each individual director and certain senior executives, and shareholders should approve the company's remuneration policy.

King Code of Governance for South Africa 2009

‘As a protector of the company, each director should also keep the following five moral duties:[6]

1. **Conscience: A director should act with intellectual honesty and independence of mind in the best interests of the company and all its stakeholders, in accordance with the inclusive stakeholder approach to corporate governance. Conflicts of interest should be avoided.**
2. **Inclusivity of stakeholders is essential to achieving sustainability and the legitimate interests and expectations of stakeholders must be taken into account in decision making and strategy.**
3. **Competence: A director should have the knowledge and skills required for governing a company effectively. This competence should be continually developed.**
4. **Commitment: A director should be diligent in performing his duties and devote sufficient time to company affairs. Ensuring company performance and compliance requires unwavering dedication and appropriate effort.**
5. **Courage: A director should have the courage to take the risk associated with directing and controlling a successful, sustainable enterprise, and also the courage to act with integrity in all board decisions and activities.'**

The duties and responsibilities of directors as required under the Companies Act[7] are dealt with in this text in chapter 27 on corporations; the ethical standards required of directors are dealt with in the web-based chapter 35 on business ethics.

2.3 Audit committees

Listed and State-owned companies must establish an audit committee. All other companies should establish an audit committee and define its composition, purpose, and duties in the Memorandum of Incorporation.

The audit committee should meet as often as is necessary to fulfil its functions, but at least twice a year. It should meet with internal and external auditors at least once a year without management being present. Audit committee members should be suitably skilled and experienced independent non-executive directors. The audit committee should consist of at least three members.

The chairperson of the board should not be the chair or a member of the audit committee. The board should elect the chairperson of the audit committee, who should be present at the annual general meeting.

The charter of the audit committee should set out its responsibilities regarding risk management. Specifically, the audit committee should have oversight of the following:

- Financial reporting risks.
- Internal financial controls.
- Fraud risks as they relate to financial reporting.
- Risks related to financial reporting.

The audit committee is responsible for recommending the appointment of the external auditor and overseeing the external audit process. The audit committee should report internally to the board on its statutory duties and duties assigned to it by the board, and to the shareholders on its statutory duties:

- How its duties were carried out.
- Whether the committee is satisfied with the independence of the external auditor.
- The committee's view on the financial statements and the accounting practices.
- Whether the internal financial controls are effective.

2.4 The governance of risk

The board should be responsible for the governance of risk. We can define risk as uncertain future events that could influence the achievement of the company's objectives, either negatively or positively.

Risk assessment should address the company's exposure to physical and operational risks, human resource risks, technical risks, business continuity and disaster risks, credit and market risks, and compliance risks.

A policy and plan for a system and process of risk management should be developed, including induction and ongoing training programmes for the board. The risk-management policy should be widely distributed throughout

the company, and the board should review the implementation of the risk management plan at least once a year.

The board should set the levels of risk tolerance once a year. The board should appoint a committee responsible for risk. This committee should consider the risk management policy and plan, and monitor the risk management process. The risk committee should have as its members executive and non-executive directors, members of senior management, and independent risk management experts to be invited, if necessary. It should have a minimum of three members and convene at least twice a year. The board should evaluate the performance of the committee once a year.

Management should execute the board's risk strategy by means of risk management systems and processes. The board should ensure that a systematic, documented, formal risk assessment be conducted at least once a year.

Risks should be prioritised and ranked to focus responses and interventions. The risk assessment process should involve the risks affecting the various income streams of the company, the critical dependencies of the business, its sustainability, and the legitimate interests and expectations of stakeholders. The board should ensure that a framework and processes are in place to anticipate unpredictable risks. The board should also ensure that management considers and implements appropriate risk responses.

Management should demonstrate to the board that the risk response provides for the identification and exploitation of opportunities to improve the performance of the company.

An internal audit should provide a written assessment of the effectiveness of the system of internal controls and risk management to the board. The board should ensure that there are processes in place enabling complete, timely, relevant, accurate, and accessible risk disclosure to stakeholders.

2.5 The governance of information technology

The board should assume the responsibility for the governance of information technology (IT) and place it on the board agenda. It should establish and implement an IT charter and policies, and should ensure the promotion of an ethical IT governance culture and awareness, and of a common IT language.

The board should ensure that the IT strategy is integrated with the company's strategic and business processes, and that there is a process in place to identity and exploit opportunities to improve the performance and sustainability of the company through the use of IT.

The CEO should appoint a Chief Information Officer responsible for the management of IT. The board should monitor and evaluate significant IT investments and expenditure. IT should form an integral part of the company's risk management. Management should regularly demonstrate to the board that the company has adequate business resilience arrangements in place for disaster recovery.

The board should ensure that the company complies with IT laws and that IT-related rules, codes, and standards are considered. The board should ensure that there are systems in place for the management of information which should include information security, information management, and information privacy.

2.6 Compliance with laws, rules, codes, and standards

The board should monitor and ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes, and standards. Exceptions permitted in law, shortcomings, and proposed changes expected should be handled ethically.

Compliance should be an ethical imperative. The induction and ongoing training programmes for directors should incorporate an overview of, and any changes to, applicable laws, rules, codes, and standards.

The company should use risk management processes to identify, assess, and respond to the risk of non-compliance. The board should delegate to management the implementation of an effective compliance framework and processes.

Management should establish the appropriate structures, educate and train, and communicate and measure key performance indicators relevant to compliance. An independent, suitably skilled compliance officer may be appointed.

2.7 Internal audit

A company should establish an internal audit function to perform the following functions:

- Evaluate the company's governance processes.
- Perform an objective assessment of the effectiveness of risk management and the internal control framework.
- Systematically analyse and evaluate business processes and associated controls.
- Provide a source of information as appropriate, regarding instances of fraud, corruption, unethical behaviour, and irregularities.

Where the board decides not to establish an internal audit function, full reasons should be disclosed in the company's annual report with an explanation as to how the company will assure effective internal controls, processes, and systems.

The board should define and approve an internal audit charter. The internal audit function should keep to the IIA standards and code of ethics. An internal audit should follow a risk-based approach to its plan. An internal audit should provide a written assessment of the effectiveness of the company's system of internal controls and risk management. The audit committee should be responsible for overseeing the internal audit.

2.8 Governing stakeholder relationships

The board should manage and measure the gap between stakeholder perceptions and the performance of the company to enhance and protect the company's reputation. The board should identify important stakeholder groupings and delegate to management the responsibility of proactively dealing with stakeholder relationships.

Management should develop a strategy and formulate policies for the management of relationships with each stakeholder grouping. The board

should consider whether it is appropriate to publish its stakeholder policies.

The board should consider not only formal, but also informal, processes for interaction with the company's stakeholders. It should take account of the legitimate interests and expectations of its stakeholders in its decision making in the best interests of the company.

A company should ensure the equitable treatment of shareholders. There must be equitable treatment of all holders of the same class of shares issued, and the board should ensure that minority shareholders are protected. The company should provide complete, timely, relevant, accurate, honest, and accessible information to its stakeholders while having regard to legal and strategic considerations.

The board should consider disclosing in the integrated report the number and reasons for refusals of requests for information that were lodged with the company in terms of the Promotion of Access to Information Act.[8]

The board should ensure that disputes are resolved as effectively, efficiently, and expeditiously as possible, and should adopt formal dispute resolution processes for internal and external disputes.

2.9 Integrated reporting and disclosure

A company should have controls to enable it to verify and safeguard the integrity of its integrated report. The company should prepare the integrated report every year. The report should convey adequate information regarding the company's financial and sustainability performance, and focus on substance over form.

The board should include commentary on the company's financial results – the integrated report should describe how the company has made its money. The board should delegate general oversight and reporting of sustainability to the audit committee. They should review the integrated report to ensure that the information contained in it is reliable and that it does not contradict the financial aspects of the report.

3 Compliance and enforcement of King III

Because King III is largely non-prescriptive, compliance is mostly treated as a matter between boards and the shareholders of companies. King III encourages greater activism by shareholders, business, and the financial press. It relies heavily on disclosure as a regulatory mechanism.

Even though compliance with King III is voluntary, there are many aspects of corporate governance contained in King III that are compulsory by law. Legal remedies may be sought under the Companies Act[9] and the common law, as well as provisions of the amended listing requirements of the Securities Exchange of the Johannesburg Stock Exchange. Refer to chapter 26 for a discussion on the Companies Act[10] and how its provisions can be enforced.

4 Insider trading

The purpose of the Securities Services Act[11] is to balance investor protection and enhance the international competitiveness of securities services in South Africa. It promotes confidence in the South African securities market, locally as well as internationally. It regulates all aspects of the South African securities markets, including the custody and administration of securities and the provision of clearing house services to an exchange.

The Act was drafted to increase confidence in the South African financial markets, promote the protection of regulated persons and clients, reduce systematic risk, and promote the international competitiveness of securities services in South Africa.

The Act prescribes a Code of Conduct for authorised users, their officers, employees, and clients. It prescribes the basic principles for the Code, while the Code itself deals with general duties of authorised users, furnishing of advice, disclosure to clients, record-keeping, inducements, advertisements, and client statements.

Insider trading refers to the illegal buying or selling of securities on the basis of information that is unavailable to the public. Manipulative, improper, false, or deceptive practices of trading as well as false, misleading or deceptive statements, promises, and forecasts now fall under the supervision of the Directorate of Market Abuse. The criminal penalty for committing any of the above market-abuse practices is a fine of up to R50 million, or imprisonment for a period of up to ten years, or both.

The Act establishes an Enforcement Committee with the power to impose an administrative penalty, or, in the case of insider trading, provide for compensation to be paid. The Financial Services Board has the power to institute legal action against insider traders for the profit made or loss avoided as a result of the insider trade, as well as a penalty of three times this amount.

PRACTICALLY

SPEAKING

Finding the right accountant[12]

Choosing the right accountant for your business can mean the difference between success and failure.

After all, it is the financial numbers that make or break your business. Small business accountants can help you with more than numbers. They can be your primary resource for:

- **Tax planning**: Beyond simply preparing tax forms, an accountant should be involved in business planning throughout the year. They should be able to regularly advise the business so it functions with peak tax efficiency.
- **Business consulting**: A good accountant should be able to help your business grow. Talented small business accountants function as a trusted general business consultant, assessing business problems and offering specific solutions. An accounting professional who really understands your business from the inside out should be a trusted business advisor who is highly motivated to see you succeed.
- **Personal finance advice**: A good small business accountant understands that your personal finances are linked to your business finances. They view both together and offer advice on both fronts.
- **Technology know-how**: Computer technology has improved small business capabilities as powerful business software is no longer only for corporations and the internet provides a level of access to knowledge, customers and suppliers hardly dreamed of even ten years ago. A good accountant must be proficient in applying the information technology that turns business data into strategic intelligence.
- **Networking**: While the strength of an accountant is still what they know, a mark of a successful professional is also who they know. Your accountant should be a good source of referrals as they should know precisely each of their clients' strengths and needs.

Here are some tips for getting started:

1. Build a referral list (four to six accountants) by contacting other business owners, your bank manager, insurance agent, trusted friends, and other successful business people. Contact all of them and ask them to discuss their services, experience, educational background, billing policies and fees.
2. Select the best three for a personal meeting. Who was the most prompt? The most thorough and best prepared? Do they have fees within your budget? Do they have professional qualifications and memberships? Are they insured? Will they work directly on your account or will they give it to another person and sign off on the paperwork?
3. Make your final selection based on how well they answered your questions, and if they seem like a partner who is looking to grow with you and help steer your business. As a final question, it is always good to let the accountant make the case for why you should hire them. It is an important decision, so take the time to do your homework.

THIS CHAPTER IN ESSENCE

1 Corporate governance involves creating structures and processes with checks and balances to enable directors to discharge their legal responsibilities and to oversee compliance with legislation.
2 The *Third King Code of Governance for South Africa 2009* (commonly known as King III) is a largely voluntary code that applies to all corporations, whether in the public, private or non-profit sectors, from 1 March 2010.
3 The board should set the values to which the company will adhere, and ensure that its conduct in all aspects of business and that of management aligns to these values.
4 The board should approve business strategy and should ensure alignment with the purpose of the company, the value drivers of its business, and the legitimate interests and expectations of its stakeholders.
5 An audit committee must have oversight of financial reporting risks; internal financial controls; fraud risks as they relate to financial reporting; and risks related to financial reporting.
6 A policy and plan for a system and process of risk management should be developed, including induction and ongoing training programmes for the board. The risk-management policy should be widely distributed throughout the company, and the board should review the implementation of the risk-management plan at least once a year. Risk assessment should address the company's exposure to physical and operational risks, human resource risks, technical risks, business continuity and disaster risks, credit and market risks, and compliance risks.
7 The board should establish and implement an IT charter and policies, and should ensure the promotion of an ethical IT governance culture and awareness, and of a common IT language.
8 The board should monitor and ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes, and standards.

9 A company should establish an internal audit function to evaluate the company's governance processes; perform an objective assessment of the effectiveness of risk management and the internal control framework; systematically analyse and evaluate business processes and associated controls; and provide a source of information as appropriate, regarding instances of fraud, corruption, unethical behaviour, and irregularities.

10 The board should consider not only formal, but also informal, processes for interaction with the company's stakeholders. It should take account of the legitimate interests and expectations of its stakeholders in its decision making in the best interests of the company.

11 A company should have controls to enable it to verify and safeguard the integrity of its annual integrated report.

QUESTIONS

Short questions (1–5 marks)

1. List two categories of directors.
2. List four issues addressed by risk governance.
3. List three issues to be considered in assessing the need for an internal audit function.
4. Distinguish between the chairperson and chief executive officer of a corporation.
5. List five functions of a company secretary.
6. List four functions of an effective internal audit function.
7. List the mechanisms to enforce compliance with the King Report.

Paragraph type questions (5 marks)

1. Discuss how a board of directors should be constituted, and explain the duties of directors.
2. Discuss what is meant by insider trading and how legislation protects against this.
3. Outline the differences between voluntary and compulsory forms of corporate governance.

4. Discuss the issues addressed by risk management.
5. Discuss the criteria to be considered in assessing the need for an internal audit function.
6. What are the benefits of an effective internal audit function?

Essay question (10 marks)

1. Discuss the nine elements of the *Third King Code of Governance for South Africa* 2009 (King III).

Problem question (20 marks)

1. You are asked to write a report on the requirements of corporate governance for your company. Write the report, setting out what the concept means, how it is to be implemented, and the legal effects on directors and shareholders.

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1 King, M, E, ‘‘The synergy and interaction between King III and the Companies Act 71 of 2008’’ in *Modern Company Law for a Competitive South African Economy*, Cape Town: Juta 2010.

2 Walker, D and Meiring, I, *King Code and developments in corporate governance*, Johannesburg: Werksmans November 2010.

3 *King Code of Governance for South Africa 2009*, Sandton: Institute of Directors for Southern Africa, 2009.

4 Ibid.

5 Companies Act 71 of 2008.

6 *King Code of Governance for South Africa 2009*, Sandton: Institute of Directors for Southern Africa, 2009.

7 Companies Act 71 of 2008.

8 Promotion of Access to Information Act 2 of 2000.

9 Companies Act 71 of 2008.

10 Ibid.

11 Securities Services Act 36 of 2004.

12 Source: www.small-business-guru.com, accessed 25 August 2008.

Chapter 29

Black Economic Empowerment

'Poverty is not natural. It is man-made and it can be overcome and eradicated by human beings. Overcoming poverty is not a gesture of charity. It is an act of justice.'

NELSON MANDELA (1918–)
FORMER PRESIDENT OF SOUTH AFRICA

What is covered in this chapter

1 Introduction
2 The purpose of Black Economic Empowerment (BEE)
3 The regulation of BEE
4 Enterprise definitions
5 Fronting practices prohibited
6 The BEE scorecard
7 The BEE Commission
8 Offences

Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

The primary purpose of Black Economic Empowerment (BEE) is to promote ownership and control by black persons over the South African economy, as measured by ownership and management.

It is important for you to understand how the BEE contribution made by businesses will be measured in a scorecard. This is because the results of that scorecard will be a highly scoring criterion in the grant by government of any licence, concession or authorisation.

1 Introduction

The legacy of apartheid led to economic imbalances that continue to exclude most South Africans from meaningful participation in the economy. In 2001, the Black Economic Empowerment (BEE) Commission's report recommended a national BEE strategy to coordinate measures to achieve meaningful participation by black people in the economy within a ten-year period.

The Strategy for Broad-Based Black Economic Empowerment, and the Code of Good Practice, explains the approach adopted by government in the measurement of BEE compliance. The Strategy and Code are not legally binding documents but provide an indication of government's current policy.[1]

2 The purpose of Black Economic Empowerment (BEE)

‘Broad-based BEE’ means the sustainable economic empowerment of all black people in particular women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include, but are not limited to:[2]

- Increasing the number of black people that manage, own and control enterprises and productive assets.
- Facilitating ownership and management of enterprises and productive assets by communities, workers, co-operatives and other collective enterprises.
- Human resource and skills development.
- Achieving equitable representation in all occupational categories and levels in the workforce.
- Preferential procurement, including the promotion of local procurement.
- Investment in enterprises that are owned or managed by black people.

The BEE Act[3] defines black people as a generic term that means Africans, coloureds and Indians who are citizens of South Africa.

BEE has three separate objectives:[4]

- Direct empowerment. This objective is the promotion of ownership and control by black persons over the South African economy, as measured by ownership and management.
- Human resource development.
- Indirect empowerment. This evaluates a range of criteria relating to a business, including purchases from black-empowered or black-owned businesses, as well as investment in, and joint ventures with, black-empowered or black-owned businesses.

3 The regulation of BEE

BEE will be regulated by government and by organisations themselves.

3.1 Government regulation of BEE

The Minister of Trade and Industry may issue Codes of Good Practice either generally or for particular sectors. These Codes will be used to:[5]

- Determine the criteria for granting licences, concessions and other authorisations under any law.
- Develop preferential purchasing policies for government.
- Define the qualification criteria for the sale of State-owned enterprises and the establishment of public private partnerships.
- Establish targets and weightings for the purpose of measuring BEE compliance.

The Minister may also promulgate transformation charters developed by consensus of the major stakeholders in various sectors within the South African economy.

Organs of State and public entities,[6] in exercising their discretion to award licences, concessions or other authorisations, must examine an applicant's BEE compliance credentials and prepare a scorecard, based on the applicant's direct and indirect empowerment and human resource development. The scorecard will be constituted either in terms of the sectoral transformation charter, or in terms of an applicable Code.

BEE compliance will not be the only requirement for the grant of any licence, concession or authorisation, but will be a highly scoring criterion amongst other evaluation factors.[7]

3.2 Self-regulation of BEE

The BEE scorecard will measure a company for its level of purchases from and investment in other BEE-compliant companies. In this way the private sector will encourage compliance by its suppliers and the entities into which it invests.

Until sectoral charters or Codes are developed, any procurement from or investment in any business satisfying the requirements of a ‘black-owned enterprise’ or ‘black-empowered enterprise’ may be counted towards the customer's or investor's BEE scorecard.[8]

3.3 Reporting

All spheres of government, public entities and organs of State must report on their compliance with BEE in their audited annual financial statements and annual reports. All public companies listed on the Johannesburg Securities Exchange must provide a report on their compliance with BEE as contained in their sustainability reports.

4 Enterprise definitions

The purpose of the additional enterprise definitions is to enable companies to diversify their ownership or investments to include charitable, socially responsible and community based organisations:[9]

- A ‘black woman-owned enterprise’ is a business with at least 25.1 per cent representation of black women within the black equity and management portion.
- A ‘community or broad-based enterprise’ is a business that has an empowerment shareholder that represents a broad base of members such as a local community where the benefits support a target group, for example black women, people living with disabilities, the youth and workers.
- A ‘co-operative or collective enterprise’ is an autonomous association of persons who voluntarily join together to meet their economic, social and cultural needs and aspirations through the formation of a jointly owned and democratically controlled enterprise.

Customers and investors with black-owned and black-empowered enterprises may count their purchases and investments in those enterprises towards their own BEE scorecards. This will make those enterprises more desirable as suppliers, or as vehicles for investment.

5 Fronting practices prohibited

A ‘fronting practice’ means a transaction, arrangement or conduct that directly or indirectly undermines the objectives of the Act.

It includes:

- The appointment of black persons who are discouraged or inhibited from substantially participating in the core activities of that enterprise.
- Economic benefits received as a result of the BEE status of an enterprise do not flow to black people in the ratios specified in the relevant legal documentation.
- A legal relationship with a black person to achieve a level of BEE compliance without granting that black person the economic benefits that would reasonably be expected to be associated with that status or position. This may take the form of an agreement with another enterprise to enhance BEE status where there are significant limitations on the identity of suppliers, service providers, clients or customers; the maintenance of business operations that is improbable having regard to resources: or terms and conditions that were not negotiated on a reasonable basis.

6 The BEE scorecard

The scorecard is used to measure progress towards BEE of businesses subject to a transformation charter or a Code. The scorecard is also relevant to any enterprise making application for a licence, a concession or other authorisation to an organ of State, or bidding for public procurement contracts.[10]

There is no standard form or content for a BEE scorecard. However, the essential components of all scorecards will measure direct and indirect empowerment, and human resource development.

The scorecard works on the basis of a weighted average. The scorecard proposed in the Code identifies seven criteria and each is given a weighting. Compliance targets for the seven criteria are set either by the applicable transformation charter or Code, and may vary between sectors. However, there must be adequate justification for the setting of a target that differs from the target set out in the Code. Also, the weighting attributable to each of the seven BEE indicators may not vary by more than ten per cent from those set out in the Code.[11]

The overall weighted average score is used to designate a business as falling into one of the following BEE contributor ratings:

- Limited contributor to BEE – a score between zero and 40.
- Satisfactory contributor to BEE – a score between 40 and 65.
- Good contributor to BEE – a score in excess of 65.

An example of how the calculations would operate is demonstrated in Table 29.1.[12]

Table 29.1 *Sample BEE scorecard*

Criterion	Weighting	Target (varies between sectors)	Actual level	Conversion	Per criterion Score
Direct empowerment					**14.6**
Ownership	20%	25.1%	12%	100% ÷ 25.1% × 12% × 20	9.6
Management	10%	40%	20%	100% ÷ 40% × 20% × 10	5
Human resource development					**18.4**
Employment equity	10%	40%	20%	100% ÷ 40% × 20% × 10	5
Skills development	20%	30%	20%	100% ÷ 30% × 20% × 20	13.4
Indirect empowerment					**23.4**
Preferential procurement	20%	30%	20%	100% ÷ 30% × 20% × 20	13.4
Enterprise development	10%	10%	10%	100% ÷ 10% × 10% × 10	10
Sector specific					**8**
Variable criteria	10%	50%	40%	100% ÷ 10% × 10% × 10	8
Overall weighted average					**64.4**

6.1 Ownership

Ownership is defined as having the twin elements of ‘economic interest’ and ‘control’. Economic interest is the more important element.

‘Control’ can mean any of the following:[13]

- The right or the ability of a BEE shareholder to direct or otherwise control the majority of the votes attaching to the shares in a company.
- The right or ability to appoint or remove directors holding a majority of voting rights at meetings of the board of directors.
- The right to control the management of a business.

6.1.1 Owners

Where a BEE investor sells their shareholding before the date their level of compliance is measured, the investor will be allowed to count the lost shareholding in the scorecard. Similarly, employee share schemes will qualify as ownership, provided the scheme's beneficiaries are able to control the shares held by the scheme and earn the economic interest associated with that shareholding.

The BEE Act includes a gender element in respect of ownership. This differentiates between male and female black persons. The financial charter has included individual targets for black women under the ownership criterion.

The Strategy and Code weight ownership at 20 per cent of the BEE scorecard. The recommendations of the BEE Commission set a target of 25.1 per cent black ownership over a ten-year period.[14]

6.1.2 External companies and international businesses

Where an international business has a subsidiary in South Africa, or where it is jointly listed on more than one stock exchange, including the JSE, then black South African ownership at any level in that international business can be counted towards the South African entity's BEE scorecard.[15]

6.2 Management

Management is evaluated according to the percentage of black persons in executive management. The BEE Act has introduced the possibility of measurement of BEE compliance at the level of management to differentiate between male and female black persons. The BEE Commission recommended management to be 40 per cent over a ten-year period.[16]

6.3 Employment equity

The Strategy and Code make reference to a weighted employment equity analysis, but there is no indication as to how this analysis is to be derived. One example is contained in the financial charter that sets out certain five-

year targets for representivity of black people in general and black women in particular at senior, middle and junior management level, based on annual remuneration. The Strategy and Code weight employment equity at ten per cent.[17]

6.4 Skills development

The Strategy and Code use skills development expenditure as a percentage of the total payroll as the indicator of skills development contribution for the purposes of the scorecard. Skills development is weighted at 20 per cent of the BEE scorecard proposed in the Strategy and Code.[18]

6.5 Affirmative procurement

'Affirmative procurement' is the percentage of total purchases sourced from suppliers that are BEE compliant. In the absence of a charter or Code setting out a BEE scorecard applicable to its sector, a supplier may rely upon its qualification as a black-owned or black-empowered enterprise under the enterprise definitions.[19]

Affirmative procurement is weighted at 20 per cent of the scorecard proposed by the Code.

6.6 Enterprise development

Enterprise development is defined in terms of the total investment by a company in other entities that are BEE compliant. In the absence of a charter or Code setting out a BEE scorecard applicable to the entity in which the investment is made, it may rely upon its qualification as a black-owned or black-empowered enterprise under the enterprise definitions.

The Strategy and Code state that enterprise development may take a variety of forms:[20]

- Direct investment in black-owned and black-empowered enterprises.
- Joint ventures with black-owned and black-empowered enterprises that result in substantive skills transfer.

Enterprise development accounts for ten per cent of the BEE scorecard.

6.7 Residual criterion

While six indicators have been laid down as standard criteria in the BEE scorecard, a seventh wild card factor, weighted at ten per cent, has been reserved in order to allow for a measure of flexibility. Sectors will be permitted to determine a residual factor most relevant to their specific circumstances. Some factors may include:[21]

- Infrastructural support to suppliers and other enterprises in the same area or community.
- Labour-intensive production and construction methods.
- Beneficiation.
- Investment and support to enterprises operating in rural communities.

- Investment in the social wage of employees. For example, housing, transport and health care.
- Local content in purchases.
- ‘Proudly South African’ membership.
- Effective corporate governance.
- Sound environmental practice.
- Research and development expenditure.
- Sponsorships and social responsibility programmes.

7 The BEE Commission

The Act creates a BEE Commission, headed by a commissioner, whose function it is to investigate complaints and to investigate BEE transactions above a value determined from time to time by the Minister. The Commission has the same powers as those conferred on the Companies and Intellectual Property Commission. The Commission may make findings as to whether any BEE transaction involved fronting practices, and may launch court proceedings to prevent any breach of the Act. In addition the Commission may report any conduct to the South African Revenue Service, the Independent Regulatory Board for Auditors, or any other regulatory authority.

8 Offences

Any government or public contract or authorisation awarded on the basis of false information in respect of an organisation's BEE status may be cancelled at the sole discretion of the organ of State or public entity without prejudice to any other remedies.

It is an offence to attempt to misrepresent the BEE status of an enterprise, or to provide false information to obtain a particular BEE status. Conviction carries a penalty of up to ten years imprisonment, or a fine of up to ten per cent of the enterprise's annual turnover.

In addition, a conviction carries a permanent ban on contracting with any organ of State or public entity.

PRACTICALLY SPEAKING

Types of legal fees[22]

The type of fee arrangement that you make with your attorney will have a significant impact on how much you will pay for their services. Legal fees depend on several factors, including the amount of time spent on your issue; the attorney's ability, experience, and reputation; the novelty and difficulty of the case; the results obtained; and costs involved. There will be other factors such as the attorney's overhead expenses, including rent, utilities, office equipment and computers, that may affect the fee charged.

Fees are additional to disbursements, which are the expenses that attorneys pay to others for their professional services. For example, the costs of hiring an advocate or of getting a traffic or medical report are disbursements, and these must be paid by the client in addition to paying the attorney's fees.

There are several common types of fee arrangements used by attorneys:

- **Initial consultation fee**: The attorney may charge a fixed or hourly fee for your first meeting where you both determine whether the attorney can assist you. Be sure to check whether you will be charged for this initial meeting.
- **Perusal fees and attendance fees**: The attorney may charge a rate per page for reading documents and may also charge for time spent in going to places.
- **Contingency fees**: The attorney's fee is based on a percentage of the amount awarded in the case. If you lose the case, the attorney does not get a fee, but you will still have to pay expenses. Contingency fee percentages vary. A one-third fee is common. Some attorneys offer a sliding scale based on how far along the case has progressed before it is settled. Courts may set a limit on the amount of contingency

fee an attorney can receive. This type of fee arrangement may be charged in personal injury cases, property damage cases, or other cases where a large amount of money is involved. Attorneys may also be prohibited from making contingency-fee arrangements in certain kinds of cases such as criminal and child custody matters. Contingency-fee arrangements are typically not available for divorce matters, if you are being sued, or if you are seeking general legal advice such as the purchase or sale of a business.

- **Flat fees**: An attorney charges a specific, total fee. A flat fee is usually offered only if your case is relatively simple or routine such as a will or an uncontested divorce.
- **Hourly rate:** The attorney will charge you for each hour (or portion of an hour) that the attorney works on your case. For example, if the attorney's fee is R100 per hour and the attorney works five hours, the fee will be R500. This is the most typical fee arrangement. Some attorneys charge different fees for different types of work (legal research as compared to a court appearance). In addition, attorneys working in large firms typically have different fee scales with more senior members charging higher fees than young associates or paralegals. If two or more attorneys are working on your matter at the same time, you will have to pay both or all of their fees.
- **Retainer fees**: The attorney is paid a set fee, perhaps based on the attorney's hourly rate. You can think of a retainer as a deposit against which future costs are billed. The retainer is usually placed in a special account and the cost of services is deducted from that account as they accrue. Many retainer fees are non-refundable unless the fee is deemed unreasonable by a court. A retainer fee can also mean that the attorney is available to handle your legal problems over a period of time. Since this type of fee arrangement can mean several different things, be sure to have the attorney explain the retainer-fee arrangement in detail.
- **Statutory fee**: The fees in some cases may be set by statute or a court may set and approve a fee that you pay. These types of fees may appear in administration of deceased estates, insolvency, or other proceedings.

With all types of fee arrangements you should ask what costs and other expenses are covered in the fee. Does the fee include the attorney's overheads and costs or are those charged separately? How will the costs for staff, such as secretaries, messengers, or paralegals be charged? In contingency-fee arrangements, make sure to find out whether the attorney calculates the fee before or after expenses.

THIS CHAPTER IN ESSENCE

1. The objectives of BEE are to promote ownership and control by black persons over the South African economy, as measured by ownership and management; human resource development; and indirect empowerment. This evaluates a range of criteria relating to a business, including purchases from black-empowered or black-owned businesses, as well as investment in, and joint ventures with, black-empowered or black-owned businesses.
2. The Minister of Trade and Industry issues Codes of Good Practice to develop preferential purchasing policies for government, and to establish targets and weightings for the purpose of measuring BEE compliance.
3. The BEE scorecard measures a company for its level of purchases from and investment in other BEE compliant companies. In this way the private sector encourages compliance by its suppliers and the entities into which it invests.
4. There is no standard form or content for a BEE scorecard.
5. The scorecard proposed in the Code identifies seven criteria and each is given a weighting: ownership; management; employment equity; skills development; affirmative procurement; enterprise development; and a residual criterion to be chosen by the company itself of a factor most relevant to the specific circumstances of the enterprise.

QUESTIONS

Short questions (1–5 marks)

1. List three objectives of BEE.
2. List two types of regulation of BEE.
3. List the two elements that comprise ownership.
4. List the seven indicators in the BEE scorecard.

Paragraph questions (5 marks)

1. Discuss the objectives of BEE.
2. Define what is meant by a ‘black woman-owned enterprise’.

3. Define what is meant by a ‘community or broad-based enterprise’.
4. Define what is meant by a ‘co-operative or collective enterprise’.
5. Discuss what is meant by ‘control’.
6. What are Codes of Good Practice for BEE, and what are they used for?

Essay question (10 marks)

1. Write notes on the seven indicators in the BEE scorecard.

Problem question (20 marks)

1. You run a small company that is about to be bought out by a large overseas group. The buyers want a report on how your company intends to implement BEE. Write the report.

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1 *The Way to BEE – A Guide to Broad-Based Black Economic Empowerment in South Africa 2004*, Sandton: Cliffe Dekker Attorneys 2004.

2 Ibid.

3 Broad-Based Black Economic Empowerment Act 53 of 2003.

4 *The Way to BEE – A Guide to Broad-Based Black Economic Empowerment in South Africa 2004*, Sandton: Cliffe Dekker Attorneys 2004.

5 Ibid.

6 Public Finance Management Act 1 of 1999.

7 *The Way to BEE – A Guide to Broad-Based Black Economic Empowerment in South Africa 2004*, Sandton: Cliffe Dekker Attorneys 2004.

8 Ibid.

9 Ibid.

10 Ibid.

11 Ibid.

12 Ibid.

13 Ibid.

14 Ibid.

15 Ibid.

16 Ibid.

17 Ibid.

18 Ibid.

19 Ibid.

20 Ibid.

21 Ibid.

22 Source: http://public.findlaw.com/library/hiring-lawyer/fee-types.html, accessed 3 January 2012. Copyright © 2012 FindLaw.com. Reprinted by permission of FindLaw.com, a Thomson Reuters company.

Chapter 30

Consumer protection

'A right is not what someone gives you; it's what no one can take from you.'

NEW YORK TIMES 2 OCTOBER 1977

What is covered in this chapter

1 To whom does the Consumer Protection Act apply?

2 Important terms

3 Fundamental consumer rights

4 Protection of consumer rights

5 Offences and penalties

6 Electronic Communications and Transactions Act

Practically speaking

This chapter in essence

Questions

WHY THIS CHAPTER IS IMPORTANT

When both parties to a contract are of equal experience, knowledge and bargaining power, both can benefit equally. However, most contracts in our society are not between equal parties, but between unequal parties; typically between powerful businesses with experienced commercial skills, and consumers, who lack commercial knowledge and have few resources. Our common law has failed to prevent people from taking advantage of others because of their financial strength and legal technical skills, and has not prevented consumers from being ripped-off by cleverly worded contracts.[1]

Parliament has passed laws to correct this imbalance. The Consumer Protection Act[2] tries to promote and advance the social and economic welfare of consumers. It does this by promoting fair business practices and setting out minimum requirements to contracts entered into by consumers. It also establishes fundamental consumer rights.

There are, however, limits as to the circumstances in which the protections offered by the Act apply. Interestingly, the same practices can be prohibited by the Act when applied to smaller consumers or transactions, and not be prohibited in respect of larger consumers or transactions. It is important for you to know the rules and exceptions as to when the Act applies, and when it does not.

1 To whom does the Consumer Protection Act apply?

As a general rule, the Consumer Protection Act[3] applies to suppliers of goods and services to consumers within South Africa.

The Act does not apply to any transaction where the goods or services are supplied to the State, or where the consumer is a juristic person with an asset value or turnover of R3 million or more. This amount is called the ‘threshold’ and is decided by the Minister of Trade and Industry from time to time.

The Act also does not apply to a credit agreement under the National Credit Act,[4] or to services supplied under an employment contract or collective agreement.

2 Important terms

- **Consumer**: A consumer is a person to whom goods and services are marketed for business reasons, or a person who enters into a transaction with a supplier. The definition includes a person who uses the goods, or who receives the services (even if not a party to the contract), or a franchisee in terms of a franchise agreement.
- **Supplier**: A supplier is a person who for money sells, markets, or rents goods, or who markets or provides business services.
- **Goods**: The concept of goods is very wide, and includes anything marketed for human consumption; any tangible thing; any intangible thing such as literature, music, a photograph, motion picture, game, information, data, software or licence; the legal interest in land or other immovable property; and gas, water and electricity.
- **Services**: The concept of services is very wide, and includes any work done by one person for the benefit of another; the provision of any education and information; any banking or financial services; the transportation of any individual or any goods; and the provision of (i) accommodation or food; (ii) any entertainment or access to any such intangible product; (iii) access to any electronic communication infrastructure; (iv) access to an event or any premises; or (v) use of any rental premises. The concept of services also includes a right of occupancy or power over any land or other immovable property; and rights of a franchisee in terms of a franchise agreement. The Act will apply to all services whether or not the person offering or providing the services participates in or engages directly or indirectly in the service.
- **Transaction**: A transaction is an agreement for the supply of goods and services. It must be the ‘ordinary course’ of the supplier's business, and the contract must take place in South Africa. Private transactions that are not in the ordinary course of a supplier's business are not covered by the Act. For example, a man who runs a business selling vegetables who sells his bicycle to a third party does not do so in the ordinary course of his business, and so the Act will not apply to the transaction. Similarly, the Act will apply to a transaction for the purchase of steel by a South African company with a turnover below the threshold, even where the contract is made with an overseas supplier.[5]

3 Fundamental consumer rights

The primary purpose of the Act is to promote and advance the social and economic welfare of consumers in South Africa. It provides a framework for consumer protection by establishing fundamental consumer rights.

3.1 Right of equality in the consumer market

The Act provides for consumers to be protected against discriminatory marketing on the equality grounds in the Constitution[6] or in the Promotion of Equality and Prevention of Unfair Discrimination Act.[7] A supplier must not unfairly favour one group of consumers over another, by excluding access or granting exclusive access to the supply of goods and services. Nor may a supplier unfairly supply different categories or charge different prices, or target communities or communities for priority supply.

The Act specifically allows differential treatment to certain groups of consumers where those goods or services are intended to satisfy the needs common to a particular group. For example, it would be reasonable for a supplier to market alcohol to adults only.

The Act also allows the use of facilities or services for the exclusive use of minors, or for adults over the age of 60 years. For example, retirement products. It is also allowed for suppliers to provide separate but substantially equivalent facilities for the exclusive use of persons of each gender. For example, toilets and change-rooms.[8]

3.2 Consumer's right to privacy

Direct marketing is where a supplier initiates the supply or promotion of goods and services. For example, ‘junk mail’ or SMS messages being sent to consumers.

The Consumer Protection Act[9] allows consumers to register a pre-emptive block against any direct marketing activities, free of charge. The block can be general and prohibit all direct marketing, or it can be specific and prohibit only a certain direct marketer. Suppliers must implement

systems to find which consumers have registered, and must not allow anyone to contact a consumer who has registered.

A direct marketer must assume that a pre-emptive block has been registered by a consumer unless the administrator of the registry confirmed in writing that a pre-emptive block was not registered. The assumption does not apply where the direct marketer has proof that an existing client expressly consented to receiving direct marketing.

The Act also regulates times when consumers can be contacted at home. No one may be contacted at home between 8 pm and 8 am during the week, before 9am and after 1 pm on a Saturday, or at any time on public holidays and Sundays. A consumer may place a sign on a post box stating that he or she does not want to receive any material related to direct marketing.

3.3 Consumer's right to choose

3.3.1 Consumer's right to select suppliers

A supplier may not require a consumer to buy specific goods or services from only that supplier or from only another specific supplier. This does not stop ‘bundling’ of goods, for example, selling a cellphone on condition that the consumer enters into a contract with a service provider for a home telephone rental at the same time.

Bundling is only allowed if the retailer can show that the deal offers the consumer convenience, and that the economic benefit of having the bundle outweighs the limitation of the consumer's right to choose.

3.3.2 Expiry and renewal of fixed-term agreements

This section of the Act does not apply to transactions between juristic persons; however, it does apply to transactions involving natural persons.

Regulations provide for a maximum term for any fixed-term consumer agreement. On expiry of the fixed-term, the contract is continued on a month-to-month basis until the consumer cancels it or agrees to another fixed-term.

No matter what fixed-term is stated in the contract, a consumer may cancel a fixed-term contract before its expiry by giving the supplier 20 business days' notice in writing. The supplier will be entitled to any

outstanding amount owed, as well as a reasonable cancellation fee. What is ‘reasonable’ depends on the amount owed; the value of the transaction up to the date of cancellation; the value of the goods; the duration of the consumer agreement; the losses suffered or benefits accrued by the consumer; the length of notice of cancellation provided by the consumer; the reasonable possibility for the supplier to find an alternative consumer; and the general practice of the relevant industry.

The supplier may only cancel a fixed-term agreement within its term if the consumer is in material breach. Twenty business days' written notice must be given, and no cancellation is allowed if the consumer remedies the breach within that period.

3.3.3 Pre-authorisation of repair or maintenance service

Where the supplier takes possession of the consumer's property to do a repair or install a replacement part or maintenance work, the supplier must provide an estimate of the costs (unless the consumer refuses the quotation or pre-authorises a specified maximum). The quotation must be supplied free of charge unless the consumer agrees to pay for preparing the estimate. Once a quotation is prepared, the supplier must not charge more than the quoted amount unless the consumer agrees to the additional costs.

3.3.4 Consumer's right to cooling-off period after direct marketing

All agreements which result from direct marketing are subject to an automatic ‘cooling-off’ period. This means that the consumer can cancel the agreement for any reason and without any penalty.

The consumer must return the goods to a supplier within five business days from the time the agreement was entered into, or from the time the goods were delivered.

A supplier must refund the purchase price of the goods within 15 business days from receipt of the consumer's notice to exercise his or her right in terms of the cooling-off provision, or the return of goods, whichever is the later.

If the goods are returned in the original unopened packaging, the supplier may not charge the consumer for payment in terms of any cancelled agreement. If the consumer has opened the packaging and used the goods, a supplier may charge the consumer a reasonable cost for the use or consumption of the goods and the reasonable costs to restore the goods to a marketable condition. No charge may be made if the consumption and use was necessary to determine whether the goods were acceptable.[10]

3.3.5 Consumer's right to cancel advance reservation, booking or order

This section of the Act does not apply to goods or services supplied to a franchisee in terms of a franchise agreement, or to any special order goods.

Generally, a consumer may cancel any advance booking, reservation or order for any goods or services to be supplied, and the supplier may charge a reasonable cancellation fee. However, no cancellation fee may be charged if the cancellation was due to the death or hospitalisation of the person for whom the booking or order was made.

3.3.6 Consumer's right to choose or examine goods

Despite any statement or notice to the contrary, a consumer is not responsible for any loss or damage to any goods displayed by a supplier,

unless the loss or damage results from the consumer's gross negligence or recklessness, malicious behaviour or criminal conduct.

3.3.7 Consumer's rights with respect to delivery of goods or supply of service

This section of the Act does not apply to goods or services supplied to a franchisee in terms of a franchise agreement.

The following are implied conditions of every transaction:

- The supplier must deliver the goods or services on the agreed date, time and place.
- Delivery takes place at the supplier's place of business (and not the supplier's residence).
- The goods to be delivered remain at the supplier's risk until the consumer has accepted delivery.

The consumer will be deemed to have accepted delivery when the consumer communicates acceptance of the goods to the supplier; or the consumer does something inconsistent with the supplier's ownership of the goods; or the consumer retains the goods for a reasonable period of time without letting the supplier know that the goods are rejected.

If delivery is made to a different location, or on a different time or date than agreed, the consumer may accept delivery, or demand delivery as per the agreement, or cancel the agreement and treat the goods as ‘unsolicited’. If a larger amount is delivered than agreed, the consumer can reject delivery, or accept the agreed goods and treat the balance as ‘unsolicited’ goods.

3.3.8 Consumer's right to return goods

Within ten business days of delivery, the consumer may return unsafe or defective goods to the supplier. The supplier must refund the price paid. A reasonable fee may be charged only if the goods have been used or need repackaging.

If the goods were sold through direct marketing and the consumer has cancelled the agreement during the cooling-off period, then the goods must

be returned at the expense and at the risk of the consumer. If the consumer has rejected delivery, or if the goods were found within ten business days after delivery to be unsuitable for the purposes they were sold, the goods must be returned at the expense and at the risk of the supplier.

Goods that have combined with or been attached to other property do not have to be returned.

3.3.9 Unsolicited goods or services

Goods or services may be ‘unsolicited’ if they are delivered without the consumer having requested them, either expressly or impliedly. This can occur with direct marketing where a supplier leaves goods or performs services without arranging payment, or where the supplier delivers a larger quantity of goods than the consumer agreed to. It can also happen in the course of an agreement to deliver goods or services periodically, where the supplier delivers goods or services that are materially different to those specified, or, after the agreement ends, the supplier continues to deliver goods.

The goods or services will only become ‘unsolicited’ if the consumer tells the supplier that they were delivered by mistake within ten business days of the delivery, and the supplier does not collect them within 20 business days after that.

Goods that are delivered to the wrong address and clearly addressed to another person only become ‘unsolicited’ goods if the consumer tells the supplier, and the goods are not collected within 20 business days after that.

The consumer cannot prevent the supplier from collecting the goods, and is not responsible to deliver them to anyone else. The consumer is also not liable for any loss or damage to the goods, unless he or she intentionally causes damage.

A person who is lawfully in possession of unsolicited goods may retain the goods or return them at the risk and expense of the supplier.

A supplier may not charge any fee for unsolicited goods or for their delivery, and any consumer who pays may recover their money.

3.4 Right to disclosure and information

3.4.1 Right to information in plain and understandable language

The Consumer Protection Act[11] requires that certain documents must be in plain and understandable language.

'Plain and understandable language' means that it must be reasonable for an ordinary consumer to understand the content and effect of the document. An ordinary consumer is someone with average literacy skills and minimal experience as a consumer of that type of goods or service.

The National Consumer Commission (NCC) may publish guidelines or codes of practice as to what constitutes plain and understandable language. Legal jargon is not allowed. Headings and diagrams should be used to make a provision easier to understand.

3.4.2 Disclosure of price of goods or services

All goods displayed for sale must be priced. A supplier must not require a consumer to pay a price higher than the displayed price; if more than one price is displayed at the same time, then the supplier can only require payment of the lowest price displayed.

A price can be displayed by a tag or label on the article itself, or on a shelf, or be published in a catalogue or brochure. If the brochure offers a special price until a certain date, then that special price will only be valid until that date. If no date is specified, then the special price will only be valid until a reasonable time after it was published.

If the price is covered fully by a second price, then the second price will be the displayed price, and will apply.

If the price is obviously wrong, the supplier will not be bound if it corrects the wrong price when it is discovered, and takes reasonable steps to tell consumers of the error and the correct price. A supplier will also not be liable if an unauthorised person removes or defaces the correct price.

If the supplier advertises or displays a discount, then the actual price will be the price on or near the goods, less the discount. However, if the supplier has marked the goods with the second, discounted price, then only the discounted price will apply.

3.4.3 Product labels on clothing, shoes and leather goods

It is illegal to import or sell clothing, shoes or leather goods unless the goods have a label with a ‘trade description’ that is in plain language and easy to read. The trade description states the country where the goods were manufactured, produced or adapted.

Only if wholly made or assembled in South Africa can the label say ‘Made in SA’, or if imported materials were used to manufacture products locally, the label must state ‘Made in SA from imported materials’. This requirement does not apply to second-hand clothing imported for charity purposes or where a natural person imports less than 1 000 items in a calendar month.

3.4.4 Genetically modified organisms[12]

Goods, ingredients or components that contain at least five per cent of genetically modified organisms may not be produced, supplied, packaged, or imported unless clearly labelled. The label must be in plain language and easy to read, and say: ‘Contains genetically modified organisms’. If it is impractical to test the goods, the notice must state: ‘May contain genetically modified ingredients’.

3.4.5 Disclosure of reconditioned or grey market goods

Anyone who supplies any reconditioned, rebuilt or remade goods with the trademark of the original producer must place a conspicuous notice on those goods.

3.4.6 Sales records

The supplier must provide a written document of each transaction. The document must show **t**he supplier's full name, or registered business name, and VAT registration number, if any; the business address; the date; a description of the goods or services; the unit price; the quantity; the total price of the transaction, before any applicable taxes; the amount of any

applicable taxes; and the total price of the transaction, including any applicable taxes.

3.4.7 Identification of deliverers, installers and others

Anyone who delivers goods or services, or installs any goods, at the address of the consumer, must wear a visible badge or form of identity, and provide suitable identification when requested.

3.5 Right to fair and responsible marketing

A producer, importer, distributor, retailer or service provider must not market any goods or services in a way that is misleading, false or deceptive regarding the benefits of the goods or services; the conditions on which they are supplied; the price or any comparative price; or any sponsorship.

‘Bait marketing’ is prohibited. This is the advertisement of goods or services that deceives consumers as to their availability. If a supplier advertises goods at a specific price but limits the quantity, the supplier must provide the full limited number of those goods at that price.

An agreement entered into through ‘negative option marketing’ is prohibited and is void. This is a promotion or inducement by the supplier that the consumer will accept goods or services automatically in future, unless the consumer refuses the offer or inducement.

3.5.1 Direct marketing to consumers

A person who directly markets any goods or services must inform the consumer of the right to cancel that agreement.

3.5.2 Catalogue marketing

This section of the Act does not apply to franchise agreements.

Special provisions apply to agreements for the supply of goods and services that are not entered into personally. For example, over the telephone or internet. The supplier must provide details of their name and registration number; business address and contact details; sales-record information; currency in which payment must be made; delivery

arrangements; cancellation, return and refund policies; and method of making a complaint.

3.5.3 Trade coupons and similar promotions

This section of the Act does not apply to franchise agreements, loyalty programmes or promotional competitions.

A person who makes or sponsors a promotional offer must ensure that there are enough prizes or goods at the reduced price to meet all the reasonably expected demands resulting from the offer.

3.5.4 Customer loyalty programmes

It is prohibited to offer participation in a loyalty programme with the intention of not providing it.

A sponsor of a loyalty programme, or supplier of goods or services who accepts loyalty credits, can restrict the availability of the rewards during any specific period by giving 20 business days' written notice before the beginning of the period. The total of all restricted periods may not be more than 90 days in a calendar year.

A person who sponsors a loyalty programme or who accepts loyalty credits must ensure that there are enough prizes or goods to meet all the reasonably expected demands in exchange for the credits.

3.5.5 Promotional competitions

A promotional competition includes any competition, game, or arrangement to distribute prizes by chance. It must be run to promote a producer, distributor or supplier, or for the sale of any goods or services. Any prize offered must be worth more than R1, and there is no requirement for a participant to demonstrate any skill or ability. The promoter must ensure that an independent accountant, registered auditor, attorney or advocate oversees and 'certifies' the conduct of the competition.

The Act[13] sets out rules relating to the arrangement of the competition, advertising, and process for determining the winners, as well as the minimum information that must be included in the entry form. The person who runs a promotional competition must keep records for at least three years, including details of the promoter; list of the prizes; marketing material; acknowledgement of receipt from the prize winner; details of the independent person who oversaw the competition draw; and a declaration from the person responsible for the competition that the prize winners were not connected to the promoter or marketing service provider.

A promotional competition may not require payment of an entry fee, except for the reasonable costs of posting or transmitting an entry. The reasonable cost of electronically transmitting an entry may not be more than R1.50. The rules of a competition must provide a prize-winner the opportunity to refuse to allow his or her photograph to be used in marketing material; to participate in marketing activities; or to be present when the draw is taking place.

3.5.6 Alternative work schemes

An advertisement to do work or run a business from home must contain a cautionary statement that discloses the uncertainty of the extent of the work available and the income that can be obtained.

3.5.7 Referral selling

A person cannot induce a consumer to accept any goods or services by promising a rebate or commission if the consumer provides names of other

people, who must also buy a product or service before the rebate or commission will be paid.

3.5.8 Agreements with persons lacking legal capacity

An agreement will be void if it was entered into by a consumer whom a court has declared mentally unfit. It is voidable if the consumer was an unemancipated minor, or the agreement was made without the guardian's consent, or it was not ratified. If, however, the consumer or someone acting on his or her behalf attempted to induce the supplier to believe that the consumer had full legal capacity, then the Act will not apply, and remedies will be decided in terms of the common law.

3.6 Right to fair and honest dealing

3.6.1 Unconscionable conduct

A supplier must not use physical force against a consumer, or coercion, undue influence, pressure, duress, harassment or unfair tactics, with regard to marketing, supply, negotiation or enforcement of an agreement, demand for payment or recovery of goods.

In addition it is unconscionable for a supplier knowingly to take advantage of the fact that a consumer was substantially unable to protect his or her own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor.

3.6.2 False, misleading or deceptive representations

A supplier is not allowed by words or conduct to directly or indirectly express or imply a false, misleading or deceptive representation concerning a material fact to a consumer. Nor may he or she exaggerate or fail to disclose a material fact if that failure amounts to a deception. The supplier must also correct any apparent misapprehension on the part of the consumer.

The following are examples of false, misleading or deceptive representations:

- The supplier of goods or services has a status or connection or sponsorship it actually does not have.
- Goods or services have ingredients or performance or approval they do not have; are of a particular standard, grade or model they are not; are new if they are actually used; been used for a period materially different from the time claimed; are the same as those previously supplied when this is not the case; or they are available for delivery within a specific time when they cannot be.
- Land has characteristics it does not actually have; may lawfully be used for purposes which are actually not legal; or is close to facilities or resources when it is not.
- Necessary maintenance or parts are available when they are not.

- Any service or part is needed when it is not.
- A charge is for a specific purpose when it is not.
- An employee or agent has the necessary authority to enter into an agreement when they do not.
- The transaction does not affect a consumer's rights when it does.
- The consumer will benefit by providing a new customer, when he or she will not.

3.6.3 Fraudulent schemes and offers

A ‘fraudulent currency scheme’ is one that involves dipping currency in a chemical substance or invoking juju or another invisible means to increase the sum of money.

3.6.4 Pyramid and related schemes

A ‘multiplication scheme’ is one that involves promising interest to an investor of at least 20 per cent above the REPO rate determined by the SA Reserve Bank. A ‘pyramid scheme’ is where participants get money mostly from their recruitment of other people, rather than the sale of goods or services. A ‘chain letter scheme’ is an agreement where participants recruit new participants, each of which pays a fee that is distributed to some or all previous participants, and moves to higher levels of participation for each successive layer of new recruits.

3.6.5 Auctions

The Act provides that a bid in an auction may be retracted before the fall of the hammer or before it is announced that the auction is complete. Notice must be given in advance that a sale by auction is subject to a reserved price; or a right to bid by or on behalf of the owner or auctioneer, in which case that person must also be present at the auction.

3.6.6 Overselling or overbooking

If a supplier accepts a reservation to supply goods or services on a specified date or time and fails to deliver because of insufficient stock or capacity to supply, the supplier must refund the consumer the amount paid, plus interest. The supplier must also compensate the consumer for costs directly associated with the supplier's breach, unless the shortage of stock or capacity was beyond the supplier's control or the supplier took reasonable steps to inform the consumer of the shortage.

For example, if an airline overbooks seats, consumers have the right to be refunded and to consequential costs incurred by them. Airlines may no longer require consumers to accept alternative flights.[14]

3.7 Right to fair, just and reasonable terms and conditions

3.7.1 Unfair, unreasonable or unjust contract terms

In terms of the Consumer Protection Act[15] a supplier must not supply goods or services at a price or on terms that are unfair, unreasonable or unjust. ‘Unfair, unreasonable or unjust’ is not defined in the Act. However, examples in the Act are where:

- The term or the agreement is so adverse to the consumer as to be inequitable, or is excessively one-sided in favour of another person.
- The consumer relied on false, misleading or deceptive representation to his or her detriment.
- The nature or effect of clauses limiting the liability of the supplier are unfair or unconscionable or were not drawn to the attention of the consumer.

The Act also provides factors for courts to consider when determining whether something is unfair. For example, whether there was any opportunity for negotiation between the parties or whether there have been previous dealings between the parties. Standard form contracts leave little to no room for negotiation by the consumer and can be found to be unfair by the courts. If a provision is found to be unfair it, or the entire contract, is unenforceable.

The court must consider a variety of factors in deciding whether a term is unfair, including:

- The fair value of the goods or services.
- The nature of the relationship between the parties.
- The circumstances of the transaction, and whether the consumer ought to have known of the term given a custom of trade and any previous dealings between the parties.

Where a term is found to be unfair, a court may order the purchase price to be repaid or property given back to a consumer; to compensate the consumer for losses and expenses; or to require the supplier to stop a practice.

3.7.2 Notice required for certain terms and conditions

Certain terms may limit the risk or liability of the supplier. This can be done by requiring the consumer to assume risk or liability or to indemnify the supplier, or to acknowledge a fact about the goods or service. If these terms are found to be unfair they will be unenforceable.

Most exemption clauses or limitations of liability will be valid if certain requirements are met:

- The clause must be fair, just and reasonable.
- It must be in writing and in plain language.
- The nature and effect of the provision must be drawn to the attention of the consumer before the consumer concludes the transaction or is required to provide payment.
- The consumer must be given an adequate opportunity to understand the meaning and effect of the provision.

3.7.3 Prohibited terms and conditions

The Consumer Protection Act[16] provides a list of prohibited terms and conditions. Any prohibited term is void.

The Act prohibits terms and conditions that:

- Try to defeat the purposes of the Act.
- Mislead consumers.
- Avoid the duties of a supplier.
- Avoid a supplier's duties under the Act.
- Limit or exempt a supplier from liability for gross negligence.
- Require a consumer to assume the risk of goods supplied by a supplier.
- Falsely state that no representation or warranty was made by the supplier (or someone on behalf of the supplier) before the agreement was entered into.
- Provide authorisation for the supplier to enter the consumer's premises to recover any goods.
- Agree to sign documents in advance without knowing if they are complete or correct.
- Agree to deposit an identity document or bank card with the supplier, or provide a PIN number to access the consumer's account.

For example, the following indemnities would be prohibited:[17]

- An indemnity where the supplier is indemnified from gross negligence.
- An indemnity that constitutes an assumption of risk on the consumer for a loss arising out of the gross negligence of the supplier.
- An indemnity that imposes an obligation on the consumer to pay for damage to goods displayed by the supplier.

3.8 Right to fair value, good quality and safety

Generally, every consumer has a right to receive goods that are reasonably suitable for the purposes for which they are generally intended; are of good quality, in good working order and free of any defects; will be useable and durable for a reasonable period of time; and comply with any applicable standards set under the Standards Act.[18] However, this does not apply if the goods were offered in a specific condition that was expressly accepted by the consumer. For example, goods sold *voetstoots*.

If the consumer specifically informed the supplier of the purpose of the goods, and the supplier ordinarily offers to supply the goods or acts in a way that is consistent with being knowledgeable about the use of the goods, then the consumer has a right to expect that the goods are reasonably suitable for the specific use indicated by the consumer.

In deciding if the goods are reasonably suitable, it does not matter whether the product failure was latent or patent or could have been detected by the consumer before accepting the goods.

3.8.1 Implied warranty of quality

The Consumer Protection Act[19] provides for an implied warranty of quality in both the supply of goods and services (excluding goods bought at auction).

Within six months after the delivery of any goods, the consumer may return the goods to the supplier without penalty and at the supplier's risk and expense, if the goods are not reasonably suitable. The consumer may require the supplier to either repair or replace the goods; or refund the price paid.

If the supplier repairs the goods, and within three months the goods are still not reasonably suitable, the supplier must replace the goods or refund the price.

3.8.2 Warranty on repaired goods

A service provider warrants every new or reconditioned part installed during any repair or maintenance work for three months or for such longer period as the supplier may specify in writing. The warranty is void if the consumer abuses the goods, or if the repair fails due to ordinary wear and tear.

3.8.3 Warning concerning fact and nature of risks

There are extra requirements for agreements under the Act concerning an activity or facility subject to risk. Where the activity or facility is of an unusual nature; or the consumer could not reasonably have known of the risk; or that could result in serious injury; there are two additional obligations on the supplier: the consumer must be given time to understand the provision, and must sign his or her agreement next to the provision.

For example, going on a rollercoaster in an amusement park. Normally, one would expect a notice to be placed at the entrance to the ride that excluded the owners and operators from any liability in respect of any personal injury you may sustain. Under the Act, it is not sufficient for a disclaimer notice to be brought to your attention when entering the park. You must be given the opportunity to understand the disclaimer, and to sign your agreement.[20]

3.8.4 Product recall

The National Consumer Commission (NCC) may receive complaints from consumers as to certain defective or hazardous goods. The NCC may investigate the nature, causes, extent and degree of risk to the public and notify consumers of the defects, hazards and risks of such goods. If the goods are unsafe the NCC can recall those goods for repair, replacement or refund.

3.8.5 Liability for damage caused by goods

The Consumer Protection Act[21] changes the legal position in cases where a consumer suffers harm or loss as a result of unsafe or defective goods.

Producers, importers, distributors or retailers of goods may be held liable for any harm caused as a result of the supply of unsafe goods or product failure. This includes a defect or hazard in the product, and inadequate instructions or warnings.

In terms of the Act ‘harm’ includes death, injury or illness of a natural person; loss or damage to movable or immovable property; or economic loss that results.

Previously in our law, anyone claiming delictual damages for product liability had to prove fault in the form of intention or negligence on the other person's part. The Act now provides for a strict form of liability which does not require fault. Producers, importers, distributors and retailers of goods and services can now be held jointly and severally liable by consumers. This means the consumer has the choice to sue them all together, or may choose any one of them to sue.

Suppliers of services who install or provide access to such goods are considered suppliers for the purposes of the Act. This means that the technician who installs your TV set can be held liable for damages or harm caused by the TV. So too may the producer, importer, distributor and retailer be held liable for any harm caused by a defect later found in the TV.[22]

The Act does allow for some defences. Liability will not arise if:

- The harm was caused entirely because of compliance with a public regulation.
- The defect or hazard did not exist at the time the product was supplied to any person in the chain of people from whom the goods were received.
- The defect or hazard arose entirely because of instructions given by someone in the chain of people from whom the goods were received.
- It is unreasonable to expect a distributor or retailer to have discovered the defect or hazard.
- A claim is launched more than three years from the time a consumer first knew of the material facts giving rise to the harm.

3.9 Supplier's accountability to consumers

3.9.1 Lay-bys

A lay-by is an agreement the consumer will pay instalments while the supplier holds the goods until the full price is paid. Until then all the payments remain owned by the consumer, while the goods remain at the risk of the supplier.

Once the price is paid in full, if the supplier is not able to deliver the goods the supplier must either deliver goods that are comparable, or refund the consumer double the money paid as a form of compensation. However, if the inability to deliver the goods was outside the control of the supplier the compensation is instead limited to a refund of the money paid plus interest. The failure will not be outside the supplier's control if it results from a failure on his or her part to carry out a routine matter pertaining to the business.

The supplier may charge a termination fee if the consumer cancels the lay-by before full payment. However, no termination fee may be charged if the reason for the cancellation was the death or hospitalisation of the consumer.

3.9.2 Prepaid certificates, credits and vouchers

A pre-paid certificate will only expire three years after the date it was issued.

4 Protection of consumer rights

The Act establishes regulatory authorities and gives them and the courts broad powers to rewrite and interpret contractual terms depending on what is equitable. Where there is ambiguity, the courts must interpret standard form contracts and other documents to the benefit of the consumer.

The Consumer Protection Act[23] establishes the National Consumer Commission (NCC) to develop industry wide codes of practice and to investigate risks to the public. The NCC may conduct investigations into product safety, and carry out a recall programme. It can also investigate conduct that is prohibited and either apply to the National Consumer Tribunal (NCT) established in terms of the National Credit Act[24] for the imposition of an administrative fine, or refer the matter to the National Prosecuting Authority for prosecution as an offence. The NCC may institute proceedings in the High Court for the recovery of an administration fine imposed by the NCT.[25]

The National Consumer Tribunal (NCT) may hold hearings into matters referred to it and issue summonses for people to appear before it to answer questions and to bring documents with them. It may declare conduct to be prohibited in terms of the Act and interdict prohibited conduct, or impose an administrative fine. Rulings and orders of the NCT are subject to appeal or review by the High Court.

The High Court may make an order declaring a transaction or agreement, partially or in full, unconscionable, unjust, unreasonable or unfair. The High Court may make any order it considers just and reasonable in the circumstances.

Instead of referring a dispute to the High Court, a consumer may refer any dispute to an applicable ombud with jurisdiction, the Consumer Court of the province with jurisdiction, or another alternative dispute resolution agent.[26]

5 Offences and penalties

The National Consumer Commission may issue compliance notices. If these are not complied with, a fine can be imposed by the National Consumer Tribunal. The amount of the fine can be up to the greater of ten per cent of the annual turnover of the business or R1 million. Employers can be held vicariously liable to pay the fines in respect of the conduct of their employees.

The courts can also impose penalties for offences. The penalty for an offence is a fine of up to ten years' imprisonment for a breach of confidentiality, or up to 12 months' imprisonment for any other offence.

6 Electronic Communications and Transactions Act

The Electronic Communications and Transactions Act[27] contains a number of compulsory consumer protections that apply to internet transactions. Failure to comply may result in the transaction being cancelled, and in some cases the seller could incur criminal liability and penalties. Provisions of the Act cannot be varied or excluded by agreement between the contracting parties.

The Act provides consumers with six fundamental protections.

6.1 Information

Eighteen pieces of relevant information must be made available on the website. This includes information about membership of any self-regulatory body to which the supplier belongs as well as the contact details of such body; details of any code of conduct to which the supplier subscribes and how that code of conduct may be accessed electronically by the consumer; details of the terms of agreement including any guarantees that apply to the transaction and how they may be accessed, stored and reproduced electronically; alternative dispute resolution; security procedures and privacy policy of the supplier in respect of payment, payment information and personal information; and the supplier's returns, exchanges and refunds policy.

Failure to provide this information allows the consumer to cancel the transaction within 14 days of receiving the goods or services under the transaction.

6.2 Review, correction or withdrawal from the transaction

The consumer must have an opportunity to review the entire electronic transaction, to correct any mistakes and to withdraw from the transaction before finally placing an order.

Failure to provide this opportunity allows the consumer to cancel the transaction within 14 days of receiving the goods or services under the transaction.

6.3 Safe and secure payment system

A payment system must be sufficiently secure in accordance with accepted technological standards at the time of the transaction and the type of transaction concerned. The supplier is liable for any damages suffered by the consumer due to a failure by the supplier to comply with this requirement.

6.4 Cooling-off period

A consumer may cancel without reason and without penalty any electronic transaction entered into within seven days from receipt of the goods or services. The consumer is entitled to a full refund of any payment made within 30 days of the date of cancellation, without prejudice to the consumer's rights under any other law. The consumer will have to pay the direct costs of returning the goods. Excluded from this protection are electronic transactions pertaining to financial services, including investment services, insurance, banking services and operations pertaining to dealings in securities.

6.5 Unsolicited goods, services or communications, or ‘spam’

The supplier must ensure that the consumer is provided with the option to unsubscribe from the mailing list by means of an accessible unsubscribe procedure. If requested, the consumer is also entitled to details of the source from which the merchant has obtained the consumer's personal information. A contravention may incur criminal liability for the supplier, who may be fined or imprisoned for a period not exceeding 12 months.

6.6 Prompt performance

The supplier must ensure that the order is met within 30 days after the day on which the supplier received the order unless the parties have agreed

otherwise. Failure to comply within the relevant period of time gives the consumer the right to cancel the contract on seven days' written notice.

The Electronic Communications and Transactions Act[28] is also covered in the web-based text in chapter 39 on cyber law.

PRACTICALLY

SPEAKING

Quick consumer tips[29]

To protect your money and avoid being a victim of fraud, keep these things in mind:

- A deal that sounds too good to be true usually is! Offers that often fall into this category are promises to fix your credit problems, low-interest credit cards, deals that let you skip credit card payments, business or job opportunities, risk-free investments and free travel.
- Extended warranties or service contracts are rarely worth what you pay for them.
- Say no to credit insurance offers. When offered with credit cards, car loans and home mortgages, it is often better to purchase regular property, life or disability insurance.
- Think twice before sharing personal information.
- Beware of payday and tax refund loans. Interest rates on these loans are usually excessive. Even a high-interest cash advance on a credit card could be a better option.
- Not all plastic cards offer the same protections. Your liability for the unauthorised use of a gift card and debit ATM card may be much higher than the amount on the gift credit card or balance in your account.
- Real estate agents represent the seller – not the buyer. When buying, consider hiring an agent or lawyer who represents you.
- Home improvement and motor vehicle repairs are the subject of frequent complaints. Second opinions are especially important when you are dealing with a repair service or mechanic you do not know.
- Avoid making big purchases during times of stress.
- Be cautious of ‘Buy Here, Pay Here’ situations. If you decide to buy a car from a used car lot, be sure to read all of the papers before you sign. Do not sign contracts that allow the dealership to change the finance rate after you leave the premises.
- Work-at-Home advertisements usually do not pay off. Be especially wary of advertisements that promise huge annual salaries; they often require expensive upfront fees with no guarantee. You risk losing your money and wasting a lot of time and energy.

THIS CHAPTER IN ESSENCE

1 The primary purpose of the Consumer Protection Act is to promote and advance the social and economic welfare of consumers in South Africa. It provides a framework for consumer protection by establishing fundamental consumer rights.
2 The Act applies to transactions in the ordinary course of business between suppliers and consumers within South Africa. However, it does not apply where the goods or services are supplied to the State, or where the consumer is a juristic person with an asset value or turnover of R3 million or more, or to a credit agreement under the National Credit Act.
3 The Act provides for consumers to be protected against discriminatory marketing on the equality grounds in the Constitution or in the Promotion of Equality and Prevention of Unfair Discrimination Act.
4 The consumer's right to privacy regulates direct marketing activities and allows consumers to register pre-emptive blocks against such activities. Regulations provide for a maximum term for any fixed-term consumer agreement, and allow cancellation at any time for a reasonable cancellation fee. All agreements which result from direct marketing are also subject to an automatic cooling-off period.
5 Consumers also are given rights with regard to choose and examine goods and services, delivery, return of unsafe or defective goods, and unsolicited goods or services.
6 The Act regulates consumers' rights to information in plain and understandable language, as well as disclosure of prices, product labels with trade descriptions, genetically modified organisms, reconditioned goods, sales records, and the identification of deliverers and installers.
7 A producer, importer, distributor, retailer or service provider must not market any goods or services in a way that is misleading, false or deceptive regarding the benefits of the

goods or services; the conditions on which they are supplied; the price or any comparative price; or any sponsorship.

8 Consumers are also provided with statutory rights to fair and honest dealing, including regulations against unconscionable conduct; false, misleading or deceptive representations, pyramid schemes, and overbooking.

9 Unfair, unreasonable or unjust terms of contract are prohibited, and notice is required for terms and conditions that seek to limit the risk or liability of the supplier. In addition, the Act prohibits certain terms and conditions entirely.

10 Generally, every consumer has a right to receive goods that are reasonably suitable for the purposes for which they are generally intended; are of good quality, in good working order and free of any defects; will be useable and durable for a reasonable period of time; and comply with any applicable standards set under the Standards Act. However, this does not apply if the goods were offered in a specific condition.

11 In terms of the Act, producers, importers, distributors or retailers of goods may be held liable for any harm caused as a result of the supply of unsafe goods or product failure. This includes a defect or hazard in the product, and inadequate instructions or warnings.

12 The Electronic Communications and Transactions Act contains a number of compulsory consumer protections that apply to internet transactions. Failure to comply may result in the transaction being cancelled, and in some cases the seller could incur criminal liability and penalties.

QUESTIONS

Short questions (1–5 marks)

1. List three circumstances in which the Consumer Protection Act does not apply.
2. Define consumer.
3. Define supplier.
4. What is a pre-emptive block in regard to direct marketing?
5. Provide an example of bundling of specific goods or services.

6. List three conditions with respect to delivery of goods or services that are implied by the Consumer Protection Act into every transaction.
7. List five examples of contractual terms and conditions that are prohibited by the Consumer Protection Act.

Paragraph questions (5 marks)

1 What services are covered by the Consumer Protection Act?
2 List nine consumer rights under the Consumer Protection Act.
3 What offences and penalties apply under the Consumer Protection Act?
4 Discuss the concept of a cooling-off period.
5 What protection does the Consumer Protection Act provide to consumers who enter into fixed-term agreements?
6 Discuss the statutory rights of consumers to return unsolicited goods or services.
7 What are the rights of consumers regarding incorrect prices on an item for sale?
8 Discuss the rules in the Consumer Protection Act relating to promotional competitions.
9 What is meant by the right to fair value, good quality and safety?
10 Discuss the changes made by the Consumer Protection Act to the common-law position regarding liability for damage caused by goods.

Essay questions (10 marks)

1. In terms of the Electronic Communications and Transactions Act, list the items of relevant information that must be available on a website.
2. Discuss consumers' statutory rights to fair and honest dealing, and to fair, just and reasonable terms and conditions of contract as provided by the Consumer Protection Act.

Problem question (20 marks)

1. Patrick is a very ambitious man who teaches himself how to write computer code, and starts an internet business from his

home in Cape Town. He is selling a love-potion, which is simply a mixture of herbs he grows outside his house and which he calls ‘African eViagra’. His website is very basic – with just a heading saying, ‘For just R50 you can last longer and make love like a lion all night!’ and a photo of naked men and women holding a sample of the love-potion, together with his bank account details (for direct deposits) and a link to a credit card processing page. Discuss the legal implications of the following situations:

a. He buys software online that automatically generates five million e-mail addresses each day, and he sends each address an email to advertise his product for sale.
b. He sends a small sample of ‘African eViagra’ to every address in the telephone directory, together with a letter that says that the receiver owes R50 for each sample. Additional samples will be sent every month.
c. Lucky writes to Patrick and says: ‘Eish! I tried double African eViagra and it does not work. I only lasted two minutes. I want my R100 back’.
d. Patrick reads in the newspaper one day that three people have died and ten people have been taken to hospital after trying ‘African eViagra’.
e. Patrick is studying business law part time, and writes the following on the bottom of his internet page: ‘The owner of this product has no liability for any claim by any consumer for anything regarding the product, ever’. He is very happy with the wording of this clause.

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2 Consumer Protection Act 68 of 2008.

3 Ibid.

4 National Credit Act 34 of 2005.

5 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

6 Section 9 of the Constitution of the Republic of South Africa, 1996.

7 Chapter 2 of the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000.

8 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

9 Consumer Protection Act 68 of 2008.

10 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

11 Consumer Protection Act 68 of 2008.

12 Genetically Modified Organisms Act 15 of 1997.

13 Consumer Protection Act 68 of 2008.

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15 Consumer Protection Act 68 of 2008.

16 Ibid.

17 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

18 Standards Act 29 of 1993.

19 Consumer Protection Act 68 of 2008.

20 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

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26 Timothy, L and Posthumus, C, *An Overview of the Consumer Protection Act*, Cape Town: Norton Rose, May 2010.

27 Electronic Communications and Transactions Act 25 of 2002.

28 Electronic Communications and Transactions Act 25 of 2002.

29 Source: www.mybank.com/consumerprotection, accessed 1 September 2008.

Chapter 31

Insolvency

'Good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws.'

PLATO (423 BC–347 BC)
CLASSICAL GREEK PHILOSOPHER, MATHEMATICIAN, WRITER OF PHILOSOPHICAL DIALOGUES, AND FOUNDER OF THE ACADEMY IN ATHENS, THE FIRST INSTITUTION OF HIGHER LEARNING IN THE WESTERN WORLD

What is covered in this chapter

1 Debt management
2 Purposes of the Insolvency Act
3 Voluntary surrender
4 Compulsory sequestration
5 Acts of insolvency
6 The final sequestration order
7 The trustee
8 Effect of sequestration on the insolvent
9 Liability of an insurer
10 Effect of insolvency on employees
11 Property outside the insolvent estate
12 Rights of the insolvent
13 Duties of the insolvent
14 Effects of sequestration on the property of the solvent spouse

15 Termination of insolvency
Practically speaking
This chapter in essence
Questions

WHY THIS CHAPTER IS IMPORTANT

What do you do when someone is not able to repay their debt to you?

A little more than two thousand years ago in Rome, a creditor had the option, in the event of a debtor being unable to pay his or her debts, either of selling the debtor into slavery or cutting the debtor's body into pieces. Where there were many creditors, an additional advantage was that there was no liability in case anyone cut off more than their just share!

Modern South African law is more lenient. Many would argue it is not as effective as the Roman law was.

1 Debt management

What can a court do where the debtor simply has no money to pay a debt? Only when debt management fails should insolvency be considered. There are various alternatives for debtors to pay their debts before considering insolvency:

- **Debt payment on credit**: This is a short-term solution and should only be used if the debtor is having a cash-flow problem and is not truly insolvent. Existing lines of credit can be used to borrow money or to free up other funds to pay off overdue creditors. Although it creates new liabilities, obtaining credit to pay debt results in new extended payment deadlines.
- **Debt consolidation**: One big loan is used to pay off many other smaller loans. The big loan is then repaid over a long-term period. This is done to secure a lower interest rate and for the convenience of having to pay only one creditor, saving on administrative and finance costs. Often it involves a secured loan against an asset that serves as collateral, for example a house.

  Debt consolidation is useful when someone is paying off a credit card debt. Credit cards can carry a much larger interest rate than an unsecured loan from a bank. Debtors with property such as a house may use the property as collateral to obtain a loan with an interest rate lower than the interest rate for the credit card.
- **Rescheduled debt payment**: Creditors are informed of the debtor's situation and they are requested to reschedule debt repayments over an extended time in lower monthly instalments. The lower monthly repayments will lessen the debtor's monthly expenditure, but will result in extended repayment periods and result in more interest being paid. When approached, creditors might immediately initiate legal action to recover the money due to them in anticipation of a possible insolvency. Rescheduled debt payment should therefore be handled very delicately.

- **Liquidation of assets**: Selling off assets can be used to generate immediate cash for debt repayment, especially amongst businesses. There may be risks with this strategy – if insufficient money is raised to pay off all the debt, there may not be enough assets left to file for voluntary sequestration; or, if declared insolvent eventually, the debtor may face allegations in terms of the Insolvency Act for preferring certain creditors to others.
- **Compromise**: The debtor liquidates his or her assets and pays secured creditors in full. After they are paid, the debtor pays a percentage of the debt owed to unsecured creditors. Most creditors will accept an amount of 50 cents or more in the rand. The balance is usually written off as bad debt.
- **Voluntary distribution**: The debtor's total debt is paid off in instalments, which are negotiated individually with each creditor. The debtor's income is first used for all necessary living expenses, thereafter payment of secured creditors and only then payment of unsecured creditors. Creditors cannot be forced to accept this proposal and must agree voluntarily.
- **Administration order**: If a person's debts do not exceed R50 000 the debtor may make an application to a magistrates' court for an administration order. This will provide some breathing space by allowing the debtor to pay off debts by making a single monthly payment to an administrator. The amount of the payment is calculated by deducting the household budget and necessary living expenses from the debtor's disposable income, as well as any payments to secured creditors. The administrator will use the money collected from the debtor to make *pro rata* payments to all the unsecured creditors every three months.

  Once an administration order has been made, the debtor may not incur further debts, or raise credit, without first explaining to the other party that he or she is under an administration order. Unsecured creditors are barred from taking any legal action against the debtor for the duration of the administration order. While an administration order is in force, no creditor has any legal remedy against the debtor or his or her property for collecting payment without the permission of the court. One exception to this is a creditor collecting money owed on a mortgage.

The creditors are entitled to attend a hearing of an application for an order of administration and may question the debtor on matters such as his or her assets, standard of living and the possibility of cutting down on expenses. The order may specify that certain assets should be sold.

2 Purposes of the Insolvency Act[1]

There are many people who owe more money than they earn or are able to pay immediately, for example a person who owes money to the bank on the mortgage bond for a house. This does not mean that every person who owes money on a house is insolvent. When we say that a person is ‘insolvent’ we do not mean that he or she is unable to pay his or her debts, but rather that the High Court has declared that person insolvent after he or she has committed an act of insolvency and his or her liabilities exceed his or her assets. Mere failure to pay a debt is not necessarily evidence of a state of insolvency.

A creditor who wishes payment may use several different remedies. If a summons gets no response from the debtor, the creditor may obtain judgment from the court and then have a warrant of execution issued. This will authorise the deputy sheriff to attach the debtor's assets, which may then be sold at auction and the proceeds used to reduce the amount owed to creditors.

The creditor may also resort to proceedings for the payment of the debt in instalments, or to garnishee proceedings, by which the court may order an employer to make payments to the creditor from the debtor's salary. Payment from other sources of income similarly may be ordered by the court. A creditor may also use the provisions of the Insolvency Act.[2]

The Act has three purposes:

- To ensure that sequestration is to the advantage of creditors.
- After insolvency proceedings, to release the debtor from future liability for the debts by rehabilitation.
- To protect creditors against the possible greed and untruthfulness of other creditors.

3 Voluntary surrender

The estate of a debtor may be sequestrated at his or her own request, that is, he or she applies to court for the acceptance of the surrender of his or her estate. This is known as voluntary surrender. The court has a discretion whether or not to grant the application.[3]

3.1 Reasons for voluntary surrender

A debtor might apply for voluntary surrender for any of the following reasons:

- To halt legal proceedings and end harassment by creditors and debt collectors.
- To stop paying creditors for years of legal fees of the creditor's attorneys, collection commission and interest.
- To solve a debt problem where creditors are unwilling to accept alternative options to restructure the debt by repayment in affordable instalments.
- To have an impartial person liquidate assets and distribute the proceeds amongst creditors in a proper way without undue preference of any one creditor over another.
- To avoid paying unjustifiable amounts for bad business decisions or mistakes.
- To enable an insolvent person to make a clean break and to provide a fresh start to rebuild his or her financial life.

3.2 Procedure for voluntary surrender

The applicant for voluntary surrender must satisfy the court of the following four requirements:

- The applicant has taken steps to notify creditors to enable them to object to the application.
- The applicant's estate is insolvent, that is, the liabilities exceed the assets.[4]

- It will be to the advantage of creditors if the estate is sequestrated. If the proceeds of the sale of immovable property or a single asset are being relied upon to prove this, then it is necessary to include an independent valuation of the property or asset.[5]
- There are sufficient assets to cover the costs of the sequestration.

Prior to the application, the debtor must publish a notice of surrender in the *Government Gazette* and in a newspaper local to his or her place of residence or business.

If the debtor is an employer, a copy of the notice of surrender has to be served on any registered trade union that represents the debtor's employees, and a copy also has to be displayed in a place accessible to the employees at the workplace.

The notice of surrender must be in the prescribed form and state the date of the application, and the place and time a statement of the debtor's affairs will be open for inspection at the office of the Master of the High Court. This notice must be published between 14 and 30 days before the date of the application. The time periods must be complied with strictly, failing which the application will be invalid.[6]

Ex parte Goldman[7]

An applicant for voluntary surrender published the notice in a weekly paper that concerned itself only with Jewish affairs and was printed in the Yiddish language using Hebrew letters of the alphabet.

The court regarded this method of publication as insufficient as the paper was one that the debtor's creditors were not likely to read.

Once published, the notice cannot be withdrawn without the express consent of the Master. After publication, none of the debtor's property that was attached by the deputy sheriff may be sold unless the property is worth less than R5 000. In that case, the Master may authorise the sale and direct how the proceeds are to be used. If the attached property is worth more than R5 000, then only the court may authorise a sale.

After publication, the Master may appoint a curator to the debtor's estate. The curator takes control of the estate as if the curator were the debtor.

The debtor must deliver or post a copy of the notice to every creditor within seven days of the date of publication in the *Government Gazette*.

Then the debtor must lodge with the Master (and the magistrate in the district in which the debtor resides or trades, if the Master is not in that district) an affidavit together with a statement of his or her affairs, setting out a balance sheet, schedule of immovable property, schedule of outstanding claims and securities, list of creditors and amounts owed, list of all books of account, and details of the reasons for the insolvency. The statement may be inspected by any creditor within 14 days from the date given in the notice of surrender.

The affidavit must contain the following:

- Full name, occupation, and place of business or residence of the debtor.
- Marital status and matrimonial property regime of the debtor.
- A positive statement that the debtor's liabilities exceed his or her assets, and details of these assets and liabilities.
- A description of the causes of insolvency. The debtor must show an absence of fraud and dishonesty on his or her part.
- Facts and figures that show that the sequestration will be to the advantage of concurrent creditors, in that there will be a dividend that will not be negligible.

What distinguishes an application for voluntary surrender from an application for compulsory sequestration is the averment (affirmation) by the debtor that the sequestration ‘will be to the advantage of creditors’, and not merely that ‘there is reason to believe that it will be to the advantage of creditors’.

4 Compulsory sequestration

A creditor who has an unsatisfied and liquidated claim may apply to court for the sequestration of the debtor's estate. A liquidated claim means the exact monetary value of the debt is certain or easily ascertainable.[8] The court may grant the order, even if it is against the express wishes of the debtor. When this process is applicable to natural persons, it is known as compulsory sequestration. When it is applicable to corporations and juristic persons, it is known as liquidation.[9] This text will concentrate on the sequestration of natural persons only.

An applicant for compulsory sequestration need only satisfy the court that:[10]

- The applicant has a liquidated claim against the debtor for an amount of R100 or more. If there are two or more creditors, their liquidated claims must be for more than R200.
- The debtor is insolvent or has committed an act of insolvency.
- There is reason to believe that the sequestration will be to the advantage of all the creditors, and not just to one creditor.

  This means that there must be a reasonable prospect that the sequestration will achieve the following:[11]

  - A dividend for creditors that is not negligible. It is sufficient if there is a reasonable prospect of substantial assets being revealed after a proper investigation in terms of the Act.[12]
  - A greater or more equitable division of assets for creditors than would have been achieved through ordinary execution.[13]

***Mamacos v Davids*[14]**

An application for compulsory sequestration failed because the applicant failed to prove that the proceeds of the assets would cover the costs of sequestration.

The court held that in those circumstances the sequestration had not been proved to be to the advantage of creditors.

A ‘friendly’ sequestration is a form of compulsory sequestration, brought about by cooperation between a debtor and a creditor. The applicant must

still show the court that there is a valid claim against the debtor; an act of insolvency has been committed by the debtor; and there is an advantage to creditors if the debtor's estate is sequestrated. Debtors prefer the friendly method of sequestration because it requires that the court simply accept that there is reason to believe that the sequestration will be to the advantage of creditors, unless this is disproved.[15]

However, there is a real possibility that the interests of creditors may be seriously prejudiced. Of great concern in friendly sequestrations is the prospect of collusion between the parties. Collusion means an agreement or mutual understanding between the parties that the one shall commit or pretend to commit an act in order that the other may obtain a remedy at law as for a real injury.[16] A friendly creditor and a friendly debtor may agree to assist each other, to the detriment of other creditors. This may be done without regard for the prejudice caused and without even seeking to explain how it has come about that the debtor is insolvent and how it came about that he was indebted to the creditor in the first place.[17]

Some of the hallmarks of collusive friendly sequestration applications include the following:[18]

- The alleged debt is usually a small loan described in rounded figures.
- No explanation is given of the reason and purpose of the loan.
- The applicant explains his willingness to make such a loan on the basis of friendship or family relations.
- The ability of the lender to make such a loan, in cash, is never stated.
- The need of the lender for the money is not disclosed.
- The financial position of the lender is seldom mentioned.
- The ability of the borrower ever to repay the loan, the anticipated source of the repayment and the basis for any confidence that this is a safe risk, are never revealed.
- There is so little detail as to such financial circumstances that the court is in no position to assess these. The court is asked to accept that the inability of the borrower to repay these quite small sums of money impacts very heavily on both lender and borrower.
- No explanation is provided why summons was not issued to recover the debt in question.
- No security of any sort is required by the lender or provided by the borrower. There is no indication that there has been an inquiry as to the

ability of the borrower to repay the loan or satisfy the indebtedness or a request for some security.

- The lender appears to have made no inquiries as to the existence of any other indebtedness of the borrower.
- The terms and conditions of the transactions go unrecorded in writing and undisclosed to the court.
- There is usually no record of any loan having taken place and the applicant is silent as to the reason for the loan, the date of the debt incurred, the period of the loan, the agreed date of repayment, the rate of interest charged and method of calculation or the terms of repayment, whether in one payment or by way of instalments.
- The actual transfer from the lender to the borrower cannot be traced and the court is not invited to track a cash or cheque withdrawal from the lender's bank or building society account, which is then converted into a deposit into the bank or savings account or other place of safekeeping under the control of the borrower.
- There is no withdrawal slip or cancelled cheque; no receipt marks the actual payment of moneys to the borrower. So trusting is the lender, that he lends money without asking for a piece of paper with a signature or a fingerprint to record that a sum of money has exchanged hands.

The creditor must set out in his or her application to the court details of the amount, cause, and nature of the claim, and whether it is a secured claim. A secured claim means that the debtor has given the creditor a claim over the subject matter of the debt in priority to other creditors. The application must be accompanied by an affidavit setting out the allegations of insolvency or details of the act of insolvency. The applicant must give a copy of the application to the Master of the High Court. Together with the application, the applicant must hand in a certificate issued by the Master within ten days of the date of the application, that the applicant has provided sufficient security (that is, a guarantee of funds) for the costs of the application.

On receipt by the debtor of a notice of application for compulsory sequestration, if the debtor is an employer, a copy of the notice has to be served on any registered trade union that represents the employees, and a copy also has to be displayed in a place accessible to the employees at the workplace.

The court may make a provisional order of sequestration if it believes that the creditor has a *prima facie* claim that the debtor is insolvent or has committed an act of insolvency, and if it appears that an order would be to the advantage of the creditors. Together with this provisional sequestration order, the court will grant an interim ruling called a *rule nisi* calling on the debtor to show cause by a specified date (called a return date), as to why the estate should not be sequestrated finally.

If the debtor is an employer, a copy of the interim ruling granting the provisional sequestration order has to be sent by the debtor to any registered trade union that represents the employees and also has to be displayed in a place accessible to the employees at the workplace.

On the failure of the debtor to show cause on the return date, the court will make a final sequestration order.

Even before the liquidation or sequestration of a debtor (provisional or final) the creditor:

- May be approached with the request to support the nomination of a specific trustee or liquidator or auctioneer.
- May decide to intervene in order to support or oppose the application.

5 Acts of insolvency

Before the court grants a compulsory sequestration order, it must be convinced that the debtor has committed an 'act of insolvency'. Proving an act of insolvency can be easier than proving actual insolvency.[19]

The Act lists various events that constitute acts of insolvency. These include:

- The debtor absents himself or herself from his or her dwelling, or from South Africa, with the intention of delaying or evading the payment of his or her debts.[20]
- The debtor has failed to satisfy a court judgment against him or her and the deputy sheriff finds insufficient disposable property to satisfy the judgment.[21]
- The debtor attempts to dispose of property in a way that would prejudice creditors or give preference to one creditor over another.[22]
- The debtor attempts to remove property to prejudice creditors or to give preference to one creditor over another.
- The debtor offers to make an arrangement with a creditor that would release the debtor wholly or partly from his or her debts.[23]
- After publishing a notice for the surrender of his or her estate, the debtor fails to lodge the necessary documents on time, or at all.
- The debtor is a trader who gives notice in the *Government Gazette* of the sale of his or her business and is then unable to pay his or her debts.[24]
- The debtor gives written notice to any creditor that he or she is unable to pay any of his or her debts.[25]

Barlows (Eastern Province) Ltd v Bouwer [26]

The debtor wrote to the creditor to apologise for not paying the debt, and asking if the creditor was willing to wait.

The court held that the debtor did not commit an act of insolvency if his notice to the creditor simply states that he is unwilling to pay immediately.

Du Plessis en 'n ander v Tzerefos[27]

The debtor sent a letter to one of her creditors regarding her outstanding account, stating that she was ‘not in a position to pay it now’ and requesting a postponement for payment against payment of interest.

The court held that a reasonable person would construe the latter as an admission that she could not pay the debt, and therefore constituted an act of insolvency.

6 The final sequestration order

The registrar of the court sends copies of the court order to the Master of the High Court, who publishes it in the *Government Gazette*; the sheriff of every district where the insolvent lives or owns property; every registrar of deeds; every officer keeping a register of ships; and every sheriff holding under any order of attachment any property belonging to the insolvent estate.

Each sheriff must then prepare a list of all movable property belonging to the insolvent estate, and send copies of the inventory to the Master and the trustee. The registrars and officers of ships must make a special notation called a *caveat* against any title deeds to prevent the transfer of any immovable property belonging to the insolvent estate.

The final sequestration order must be served on the insolvent and his or her spouse. The insolvent must deliver all records of his or her affairs to the person serving the notice on him or her. Within seven days both the insolvent and the spouse must deliver a statement of affairs to the Master.

Civil legal proceedings by or against the insolvent are stayed on sequestration, until such time as a trustee has been appointed.[28]

7 The trustee

The Act divests the insolvent debtor of his or her estate and vests it in a trustee. All civil proceedings against the debtor in respect of the debts are halted.[29]

The property of the insolvent's spouse also vests in a trustee, who must release any property of the solvent spouse that is proved to be the solvent spouse's own property. It is not the design of the Act to saddle the solvent spouse with the liabilities of the insolvent, but to bring into the insolvent estate property that might have been transferred to the solvent spouse in an act of fraud against creditors.

The trustee or liquidator in certain cases must also obtain the consent of creditors to continue the business of the insolvent. A lot of bargaining and discussion normally goes on at this time as potential trustees and potential liquidators and auctioneers all attempt to obtain appointments and to favour their own positions.

If a creditor has registered a name and address with the trustee or the liquidator, such creditor is supposed to receive notice of the meetings of creditors. However, the first meeting of creditors is convened by the Master of the High Court and in many cases even the trustee or liquidator is not aware of the date on which the first meeting is to be held.

The most important business at a first meeting involves the following:

- The creditor must prove the claim as prescribed in the Act. The claim must be lodged timeously.
- Lodgment of a power of attorney.
- The creditor is entitled to inspect the documents lodged. This is important since the creditor may learn something about the extent of the debts of the debtor.

In certain circumstances creditors who have proved claims may become liable to pay a contribution should the funds of the estate not be sufficient to pay the administration costs. If there is uncertainty as to whether a contribution will be paid or not, then the creditor is advised not to prove a claim at the first meeting.

One or more trustees or liquidators are elected by the creditors at this meeting. Creditors should therefore decide prior to this meeting whether the creditor is going to vote for a specific trustee or liquidator. Creditors often work together in order to reach agreement as to the identity of the trustee or liquidator to be supported by them. The trustee is elected by the majority of creditors who have proved claims, at the first meeting of creditors. This election then is confirmed by the Master.

The right that a creditor had before sequestration (to obtain satisfaction of his or her claim by judicial proceedings) is modified. A creditor's sole redress now is to prove a claim against the insolvent estate for the purpose of sharing in the proceeds of that estate with all the other proven creditors. On insolvency, a collective of creditors comes into existence. This is known as a *concursus creditorum*. The concept presupposes a number of creditors with conflicting interests in pursuing their claims against the debtor's property.[30] The insolvent estate is frozen and it is no longer possible for any one creditor to do anything that would have the effect of altering or prejudicing the rights of other creditors.[31] Nothing can be done to reduce the insolvent's assets or disturb the preferential claims of creditors.

The trustee must take control of all movable property, books and documents and immovable property belonging to the estate. The trustee must also start debt recovery proceedings against anyone who owes money to the insolvent estate. He or she keeps a receipt book, and operates an estate bank account and saving account. The trustee may only carry on the business of the insolvent with the authorisation of the creditors or the Master. The trustee investigates the business affairs of the insolvent and reports to the creditors at the second meeting.

After the first meeting, and apart from any other special meetings or general meetings, the second most important meeting is the second meeting.

The business at this meeting is to prove further claims; receive the report of the trustee or the liquidator; and to pass resolutions giving directions or instructions to the trustee or the liquidator.

If not already done, the trustee or the liquidator will continue with the realisation of assets after the second meeting of creditors.

Creditors who hold movable property as security must take note of the provisions of section 83 ‘Realisation of securities for claims’ of the Act.

Few creditors make use of this provision, presumably because they are not aware of it.

The insolvent may also be interrogated under oath to determine his or her true financial position. The interrogation may take place at the second meeting, or at a special meeting of the creditors.

The matters that may be the subject of the interrogation include:

- All matters relating to the insolvent or his or her business affairs.
- Any property belonging to the insolvent estate.
- The business affairs or property of the solvent spouse.

The insolvent may be represented legally at the interrogation, and must attend himself or herself, and produce documents that are requested. Only if the presiding officer is a magistrate can an insolvent, who refuses to attend or produce documents requested, be sent to prison for the failure.[32]

The trustee must collect all assets and, if necessary and acting on instructions from the creditors, take steps to set aside certain transactions entered into by the insolvent before sequestration. These are known as assailable or impeachable transactions.

***Mackay v Fey NO and another*[33]**

The trustees of an insolvent estate applied for repayment of rental paid by the insolvent's wife for the lease of an expensive property, alleging that the insolvent was the true lessee.

The court held that before it could hold a transaction to be simulated or dishonest, it had to be satisfied that there was some deliberately concealed tacit understanding between the parties to the agreement. The trustees had to show that the lessor's true intention was to contract with the insolvent and not with the wife. As there was no direct evidence that the lessor or his agents had known of the insolvent's status, the trustees failed.

The following transactions may be set aside by the court on application by the trustee, or by a creditor in the name of the trustee:

- **Dispositions without value**: Any disposition not made for value (for example, a donation) may be set aside by the court. If the disposition was made more than two years before sequestration, it will be set aside only if it is proved that the liabilities of the debtor exceeded his or her assets immediately after the disposition was made. If it were made

within two years of the sequestration, the person to whom it was made must prove that the assets of the debtor exceeded the debtor's liabilities immediately after it was made.

Geyser NO and others v Telkom SA Ltd [34]

The liquidator applied for an order to set aside dispositions that had been made in favour of Telkom within two years of the provisional liquidation of a medical aid scheme. The dispositions consisted of payments to Telkom in settlement of several accounts for telephone and telecommunication services. Telkom's defence was based on a section of the Act that renders certain rights unaffected by potentially improper dispositions. Telkom had to prove, on a balance of probabilities, that it had lost a right against another person; such loss of a right was in return for a disposition which was liable to be set aside; and that it had acted in good faith.

The court held the payments had indeed been made, and were dispositions without value. Telkom could not prove that it had lost a right against a third party as a result of the payments that it had received from the scheme. The court further did not accept that Telkom had received the payments in good faith.

- **Voidable preferences**: The Act maintains that all creditors should be treated alike as far as possible. Any disposition by the debtor that has the effect of preferring one creditor over another creditor, and was made within six months of the sequestration, may be set aside by the court if the liabilities of the debtor exceeded the debtor's assets after the disposition was made. The court will not do so if the debtor proves that the disposition was made in the ordinary course of business, and was not intended to prefer any creditor.[35]

Gore and others NNO v Shell South Africa (Pty) Ltd [36]

The court dealt with the issue of voidable preferences. Four days before the commencement of its winding-up the company paid a large amount of money to the defendant, which was one of its creditors. The plaintiffs were the joint liquidators of the company, and they applied to court to set aside that payment as being a voidable preference.

The order was granted. The court held that in order to succeed, the plaintiff must prove that (1) There was a disposition by the company of its property. (2) The disposition was made not more than six months before the liquidation of the company. (3) The disposition was made to the defendant, who was a creditor of the company at the time. (4) The disposition had the effect of preferring the defendant above the company's other creditors. (5) Immediately after the making of such disposition the liabilities of the company exceeded the value of its assets. Once the plaintiffs have established these requirements, the onus then shifts to the creditor to prove that the disposition was made in the ordinary course of business, and that it was not intended to prefer one creditor above another.

- **Undue preference to creditors**: Where the debtor disposes of property at a time when his or her liabilities exceed his or her assets, and with the intention of preferring one creditor over another, the court may set the disposition aside. The applicant must prove both elements to succeed in court.[37]
- **Collusive dealings before sequestration**: The court may set aside a transaction in which creditors are prejudiced or one creditor is preferred over another.
- **Voidable sale of a business**: In terms of section 34 of the Act, a trader may sell his or her business only if he or she has published notice of the sale in the *Government Gazette* and in two issues of an English and an Afrikaans newspaper circulating in the area, between 30 and 60 days before the sale. If the trader fails to do so, then the sale is void as against his or her creditors for six months after that. If his or her estate is sequestrated within six months of the sale, the sale will be void against his or her trustee also for that period.

Gore NO v McCarthy Ltd [38]

The liquidator of a company in liquidation applied for an order declaring void the transfer of 28 trailers to the defendant, valued at over R2 million. The defendant opposed the application on the basis that it was not a 'trader' as defined in the Act, but was a transport contractor. The liquidator argued that because the defendant had as part of its normal trading activities the purchase and sale of vehicles and trailers, it qualified as a 'trader' for purposes of the Act.

The court held that in order for the company to have been a 'trader', it was not necessary that the transaction had been concluded in the ordinary course of its primary business. It was sufficient that the transaction had been concluded in the ordinary course of a business ancillary to its primary business. The transfer of the 28 trailers was accordingly declared void.

- **Set-off**: If the estate of a person who has set off any debt is sequestrated within six months of the set-off, the trustee may abide by the set-off, or call on the other party to pay the debt to the estate.

The trustee must arrange for the sale of the assets as quickly as possible. Detailed provision is made for meetings of creditors at which directions are given by the creditors to the trustee with regard to any matter concerning the administration of the estate and the voting powers of creditors.

After the sale of the property of the insolvent estate, the trustee must distribute the proceeds among the creditors in the order of preference set

out in the Act. The claims of secured creditors are met first. The remainder is known as the free residue, which is used to meet the remaining claims.

The order of preference for secured creditors is as follows:

- Where the asset is immovable: the holder of an enrichment lien, mortgage bond, debtor and creditor lien.
- Where the asset is movable: the holder of an enrichment lien, statutory instalment sale hypothec, pledge, landlord's tacit hypothec, debtor and creditor lien.

The order of preference for unsecured creditors to be paid from the free residue is as follows:

- Death expenses of the insolvent, or his or her spouse or minor child.
- Costs of sequestration.
- Costs of execution.
- Monies owed by the insolvent estate in terms of any statute, for example outstanding unemployment insurance contributions.
- Portions of salaries owed to employees of the insolvent up to certain maximums.
- Taxes.
- Unsecured claims in terms of a general mortgage bond over movables.
- Unsecured claims from creditors in proportion to the amount of each claim.

If an employer is sequestrated, all contracts of employment would be suspended until such time as the trustee decided whether or not to terminate the contract. Until that decision was made, an employee would not have to work, but would not be paid or be eligible for benefits under the Basic Conditions of Employment Act.[39] However, the employee could make a claim for unemployment benefits immediately from the date of the suspension.

The trustee would be required to consult with the parties to any applicable collective agreement, workplace forum, or registered trade union, or the affected employee, prior to making any decision to terminate any contract of employment. The purpose of the consultation is to attempt to agree on how the business, or any part of it, may be saved.

Creditors may participate in the consultation as long as the trustee agrees. An employee whose employment was terminated would be able to claim severance benefits in accordance with the formula set out in the Basic Conditions of Employment Act.[40]

The next important step is for the trustee or liquidator to prepare the liquidation and distribution account and, if applicable, a plan of contribution. The account will lie open for inspection and once it has been approved and dividends have been paid to creditors, it cannot be reopened and will be final. Creditors must therefore inspect the account and object timeously should they not agree with the liquidation and distribution account.

The trustee must liquidate and distribute the assets of the estate. After payment of dividends have been made to creditors, the insolvent, after the expiry of certain periods that may vary according to the severity of insolvency, may apply to court for rehabilitation. In any event, after the expiry of a period of ten years from the date of sequestration of the estate, an insolvent is deemed to be rehabilitated unless the court, on the application of an interested person, orders otherwise.

The rehabilitation of the insolvent puts an end to the sequestration, discharges all pre-sequestration debts, and relieves the insolvent of every disability arising from the sequestration.

8 Effect of sequestration on the insolvent

The estate of an insolvent comprises all his or her property at the date of sequestration and all property that he or she may acquire during the sequestration. Once a court grants a sequestration order, the registrar sends original copies to every deputy sheriff of every district in which it appears that the insolvent resides or owns property, and every officer responsible for the registration of immovable property in South Africa. This is to prevent the improper transfer of immovable property out of the insolvent estate.

The deputy sheriff then must attach and make an inventory of the movable property of the insolvent estate that is capable of manual delivery, and not in the possession of someone claiming to be entitled to retain it under a right of pledge, or right of retention, or under attachment. If the creditor wants the property to be removed to a place of storage and safekeeping, this can only be done by the deputy sheriff.

Any person interested in the insolvent estate may be present when the deputy sheriff makes the attachment. The deputy sheriff then must submit a full report to the Master and a copy of the inventory to the trustee.[41]

9 Liability of an insurer

Insurers have tried to avoid liability for insurance claims in circumstances where the estate of an insured is sequestrated. They have done this by stating that since only the insured may claim under the contract of insurance, and since a third party could only sue the insured, once the estate of the insured was sequestrated this effectively put an end to any claim the third party might have had.[42]

The situation was remedied by section 156 of the Insolvency Act,[43] which provides that a creditor may claim directly from the insolvent's insurer. The Act states that whenever any insurer is obliged to indemnify an insured in respect of any liability incurred by the insured towards a third party, the third party shall, on the sequestration of the estate of the insured, be entitled to recover from the insurer the amount of the insured's liability towards the third party up to the limit of the indemnity.

The legislation was enacted so as to enable the person who had suffered the loss to pursue the claim directly against the insurer. All that is required is that the insurer be bound contractually to indemnify the wrongdoer. Section 156 does not apply only where it is the insured who has incurred the liability to the plaintiff; it applies expressly whenever the insurer is obliged to indemnify any person in respect of the liability that is the subject of the claim.

10 Effect of insolvency on employees

Once an employer is rendered insolvent, obligations between employers and employees in terms of their contracts of employment are suspended. This means that employees are not obliged to tender their services and employers do not have to pay employees.

Despite the fact that contracts of employees are suspended, employees are deemed to be unemployed for purposes of the Unemployment Insurance Act.[44] This allows them to register for unemployment benefits as if they had been dismissed.

A trustee may employ certain of the employees of the insolvent employer in order to continue running the business. The trustee may, however, terminate the contracts of service of the employees. The trustee may not exercise this power unless he or she has entered into consultations regarding measures that could be adopted to save a whole or part of the business. These consultations must be held with the employees, their trade unions or any other representatives of the employees. A creditor of the insolvent employer may also participate in these consultations, with the agreement of the trustee.

In the absence of an agreement between the trustee and the employee(s), employment contracts not already terminated will terminate 45 days after the appointment of the final trustee.

Section 38(11) provides that, for purposes of severance benefits, employees whose services are terminated as a result of insolvency are treated as employees who have been dismissed because of the employer's operational requirements. The claim for severance benefits will be against the estate of the insolvent employer.

11 Property outside the insolvent estate[45]

The following property does not fall into an insolvent estate:

- **Remuneration and earnings for work done after sequestration**: The insolvent may retain only what is necessary to support himself or herself and any dependants.
- **Pension monies**: Annuity payments may not be attached by the trustee.
- **Compensation awards made by the court for loss or damage**: Damages received for personal suffering in defamation or personal injury actions may not be attached.
- **Clothing and other means of subsistence**: The amount that the insolvent may retain is decided by the creditors.
- **Insurance policies**: In general, this applies to limited amounts in respect of policies effected by a single person on his or her own life, policies effected by a married woman on her own life, and policies effected by a man on his own life and ceded to his wife or effected in favour of his wife. These exclusions are dependent on whether the couple was married in or out of community of property.
- **Compensation under the Compensation for Occupational Injuries and Diseases Act**.[46]
- **Benefits under the Unemployment Insurance Act**.[47]
- **Property excluded in terms of the Land Bank Act**.[48]
- **Trust monies of an attorney, notary, or conveyancer**.
- **Property acquired with money received by the insolvent from property that does not fall into the insolvent estate**.

12 Rights of the insolvent

The insolvent may not dispose of any property of the insolvent estate and may not enter into any contract in which the estate is likely to be adversely affected. These contracts are not void, but voidable at the election of the trustee. The insolvent may only alienate property acquired after the sequestration and with the consent of the trustee.

The insolvent may carry on any profession or occupation, but requires written consent from the trustee to be employed, or have anything to do with, the business of a trader who is a general dealer or manufacturer. As a result, the insolvent is excluded from any undertaking where property is sold, bought, exchanged, or manufactured; where there are building operations; and where the purposes are for public entertainment or the business of a hotel-keeper. The insolvent may not engage in the production of a finished article from raw materials or from a combination of other materials.

The insolvent may sue or be sued in his or her own name in matters relating to status, or to any right to the extent that it does not affect the estate. He or she may sue, without reference to the trustee, for any pension due to him or her, for any compensation for loss or damage from injury or defamation, or for any remuneration for professional work rendered. The insolvent may be sued in his or her own name for any delicts committed by him or her after sequestration, for which the insolvent estate is not liable.[49]

13 Duties of the insolvent

If it becomes clear to a person that his or her estate is likely to be sequestrated, it is that person's duty to not make any payments to any one or more of his or her creditors, and to preserve the assets for equal distribution among the creditors. If that person fails to do this, he or she may be liable for criminal prosecution, and the payment itself is likely to be set aside as undue preference.

The insolvent must keep a detailed record of all assets received by him or her and all disbursements made by him or her in the course of his or her profession, occupation, or employment, and submit statements to the trustee every month.

The insolvent, before the second meeting of creditors, must assist the trustee in realising any property belonging to the estate, provided that the trustee gives to the insolvent from the estate an allowance in money or goods that, in the opinion of the Master, is sufficient to support the insolvent and any dependants.

The insolvent must attend each meeting of the creditors if required to do so by the trustee. If he or she does not attend, he or she may be imprisoned.

Once the provisional or final order has been granted, the creditor may take steps in order to ensure that an interrogation takes place of the debtor to ascertain the extent and whereabouts of any remaining assets. The creditor himself may be called as a witness to the interrogation. The creditor is in certain circumstances entitled to legal representation and in certain circumstances not entitled to legal representation at the interrogation. The creditor may in certain circumstances participate in the interrogation.

A person who is duly summoned to an enquiry, who fails to produce the requested books and documents or fails to answer the required questions lawfully put to him, may be detained until he undertakes to do what is required of him. The warrant for the detention is issued by the presiding officer of the enquiry. These provisions have since been found to be unconstitutional and invalid.[50]

D M De Lange v F J Smuts NO and others[51]

The court had to decide whether to grant an application by the liquidators of a close corporation for the imprisonment of its sole member. This was because he had failed to produce the books and documents he had been subpoenaed to produce at a second meeting of creditors and had also failed to answer questions put to him fully and satisfactorily.

The court held that a decision could not be made without first deciding whether the provision violated the right to freedom and security of a person as contained in the Constitution. The meaning of ‘trial’ implied the examination and determination of a cause by a judicial tribunal and the determining of the guilt or innocence of an accused person by a court. Since the presiding officer of an enquiry referred to in section 66 of the Act could be the Master, a designated officer or a magistrate, the hearing was therefore not a court hearing as required in terms of the Constitution. Accordingly, the court held that section 66 of the Act conflicts with the right to liberty enshrined in the Constitution.

The court held that even though administrative deprivations of liberty would in some cases be necessary even in societies placing a high value on freedom, they would not be allowed where other coercive and punitive measures were available which could fulfill the same function and which were less invasive of a person's fundamental rights. The fact that a witness may apply to court for his or her release if he or she has been wrongfully detained, is no solution: ‘One cannot hold false arrest or imprisonment to be constitutionally legitimate because a competent court may be relied upon to set the arrestee or detainee free.’

The court declared the provisions of section 66(3) to be inconsistent with the Constitution and therefore invalid.

14 Effects of sequestration on the property of the solvent spouse[52]

It is a common perception that unscrupulous persons may try to avoid payment of their debts by putting property into their spouses' names. Under the common law, it was assumed that on insolvency the burden rested on the trustee to attack the spouse's title. However, this is now not the case.

Section 21 of the Insolvency Act[53] changed the common-law position, by vesting in the trustee of the estate of an insolvent all the property of the solvent spouse, and placing the onus on the solvent spouse to show that the property claimed is, in fact, the solvent spouse's separate property. Now the trustee is invested with all the property of the spouse whose estate has not been sequestrated, as if it were the property of the sequestrated estate.

The provisions of section 21 of the Act apply only to spouses married out of community of property. This is because where spouses are married in community of property there is only one estate: the joint estate. The word ‘spouse’ in terms of the Act refers not only to persons married to each other, but also to unmarried persons living together as husband and wife.

Du Plessis v Pienaar NO and others[54]

The court considered whether the separate estate of a solvent spouse married in community of property could be attacked by creditors.

In 1983, Du Plessis inherited assets on the death of her father. In terms of his will these assets fell into her separate estate. She was married in community of property at the time. When the joint estate was sequestrated in 2000 as a result of the failure of her husband's business, the trustees of the insolvent estate claimed her separate property for the benefit of creditors.

The court held in favour of the creditors. Debts are not incurred by a person's estate – the estate is merely the source from which the debt is recovered. The debt is incurred by the person who is the debtor. When spouses are married in community of property both spouses are generally liable for payment of the debts that are incurred by one of them. It follows that a creditor may look to the estates of both the debtors for the recovery of the debt. That estate comprises not only her undivided interest in the joint estate but also her separate property that falls outside the joint estate.

The solvent spouse, on the provision of security, may apply to court, by way of motion proceedings, for the exclusion of certain property from the effects of section 21 of the Act, if the application of that section would

adversely affect the solvent spouse. For example, if the solvent spouse carries on the business of a trader and the property is his or her business premises. The court can only do this if satisfied that the solvent spouse can and will safeguard the interest of the insolvent estate in the property concerned.[55]

The solvent spouse may also claim his or her own property by way of affidavit to the trustee. The affidavit must be supported by an antenuptial contract, vouchers, receipts, and paid cheques.

The trustee must release any property of the solvent spouse that is proved to have been:

- The solvent's property immediately before the marriage to the insolvent.
- Acquired by the insolvent under a marriage settlement in the form of an antenuptial contract.
- Acquired by the solvent spouse during marriage to the insolvent, by a title valid against creditors of the insolvent. However, in the following circumstances, the property will be deemed to be the insolvent's property and will form part of the insolvent estate:[56]
  - The insolvent spouse obtained the property from the insolvent during marriage as a donation.
  - The insolvent spouse gave money to the solvent spouse to obtain the property and have it registered in the solvent spouse's name.
  - The solvent spouse bought property with money provided by the insolvent, ostensibly for the solvent spouse, but in reality for the insolvent's estate, or even for the benefit of both spouses.
- Safeguarded in the solvent spouse's favour by the Long-Term Insurance Act.[57]
- Acquired with any of the income or proceeds of any property mentioned above.

If the trustee has released any property alleged to belong to the solvent spouse, the trustee subsequently may prove that it still belongs to the insolvent estate and recover it accordingly. The solvent spouse may apply to court to compel the trustee to release the solvent spouse's property. The onus of proof is on the solvent spouse.

Cothill v Cornelius NO[58]

Information obtained at the inquiry led the trustee to believe that the insolvent and his wife were colluding with each other to hide his assets. The following day, the trustee attended certain business premises to remove movable property situated there.

The court held that section 21(1) of the Act, which provides that all the property of a solvent spouse vests in the trustee as if it were the property of the sequestrated estate, does not in itself authorise the removal of the property of the solvent spouse.

Section 69(1) obliges the trustee of an insolvent estate to take into his or her possession all movable property belonging to the estate, but this cannot be done before the deputy sheriff has made an inventory of the estate assets as provided for in section 19(1). That section makes no provision for the assets of the solvent spouse. There being no statutory basis upon which the trustee could remove the wife's assets, the common law prevailed and the wife was entitled to rely on her right not to be unlawfully dispossessed of her assets.

Even if the trustee had relied on section 69(3), which entitles the removal of property belonging to a third party, the procedure of obtaining a warrant from a magistrate would have been necessary.

Generally, the trustee is allowed to sell the property only on six weeks' written notice of the sale being given to the solvent spouse at the place of residence or business, and published in the *Government Gazette* and a local newspaper.[59]

15 Termination of insolvency

This is known as rehabilitation, and has the effect of ending the sequestration and terminating all debts that were due.[60]

Applications to court for rehabilitation may be made in any of the following cases:

- The Master has issued a certificate verifying that the creditors have agreed to a composition, that is, an offer of settlement. Security must be given by the insolvent for 50 per cent of the amount of the composition.
- The Master confirms that all proved claims, plus interest, and all costs have been paid in full.
- After six months from the date of sequestration, no claim has been proved against the insolvent estate.
- After 12 months after the Master has confirmed the first account, provided that the Master recommends rehabilitation, the estate has not been sequestrated before, and he or she has not been convicted of any fraudulent act in connection with the insolvency. If convicted of any fraudulent activity regarding the insolvency, he or she can only apply for rehabilitation after five years from the date of the conviction.
- Four years from the date of sequestration.

The court application must be accompanied by an affidavit that must state that the insolvent has surrendered the estate and has not promised anyone any benefit to not oppose the application. The insolvent must provide information regarding his or her assets and liabilities, the dividends (that is, amounts) paid to date to his or her creditors, the total amount of the claims proved, and the total liabilities at the date of the application.

The trustee must report to the Master regarding any facts that may influence the court in deciding whether or not to grant the application. The Master, trustee, or a creditor may oppose the application. The application for rehabilitation is not a mere rubber-stamping exercise, and requires a full and frank disclosure of all relevant facts. Even if the Act has been complied with, the court may refuse or postpone the application, or grant it subject to conditions. The simple test is whether the applicant is a person who ought

to be allowed to trade with the public on the same basis as any other honest person.[61]

***Ex parte Roos*[62]**

The insolvent had failed to lodge the necessary statement of his affairs, attend meetings with creditors, and provide assistance to the trustee. At the time of his application for rehabilitation he was earning a high income.

The court noted its disapproval by ordering rehabilitation subject to the condition that he pay an increased dividend to creditors.

***Greub v The Master and others*[63]**

An insolvent applied for rehabilitation within four years of sequestration. His application was not supported by the Master. His creditor had not been paid in full, no details were given of overseas money nor was any of this used to pay the creditor, and he had been highly obstructive in the administration of his estate.

The court held his application for rehabilitation should be refused.

The insolvent will be deemed to be rehabilitated after ten years from the date of sequestration, unless a court orders otherwise within that time.

PRACTICALLY SPEAKING

Seven ways to make sure that your business gets paid on time

You may be very successful at selling things, but what if you do not get paid? You cannot pay your suppliers with promises! At all times you need enough money to pay the business' debts. Cash flow is everything in a business. If you do not have enough cash to pay the bills your business will be liquidated. You need properly run credit control procedures in place to ensure that the business can pay what it owes, and that it collects money in good time from all who owe it debts:

1 Be clear about your expectations for payment

You may want to be paid immediately, but perhaps your customers want ninety days' credit. What is the standard time for payment in the industry in which your business operates? You must tell your customers before you sell anything to them what the terms of payment are for the contract. These terms of payment should be included into your business' standard terms and conditions and customer contracts, and should also be written clearly on every quotation and every invoice you issue.

2 Make it simple to pay your business

Do not make it difficult to get paid. Make it clear how to pay by credit card, cheque or direct debit, and provide all the necessary account names, numbers and details of banks.

Provide special bank accounts into which customers can deposit the necessary funds, and also make certain that it is possible for customers to pay your business over the internet.

3 Do credit checks on all new customers

It is much cheaper to do a credit check than to have a bad debt. Make certain that you understand the National Credit Act and obtain advice from your attorney about how to avoid providing credit to customers.

4 Encourage customers to pay quickly

Consider granting an incentive to customers if they pay quickly, and make sure they know they can save money if they do so. Speak to your accountant about how much ‘early payment’ discounts would cost, and how these can be funded.

5 Be very clear about credit procedures

Develop a clear policy and procedure for granting credit, and how to administer accounts where payment is required. Your attorney can help you with standard letters, e-mails and SMSs to send out at specific dates, such as after seven or 14 days. Remember that these people are your valued customers, so do not be offensive, threatening or rude. You should be polite and firm, and remind them that interest will be payable on all overdue balances.

6 Take action quickly

By their non-payment, customers who do not pay you threaten the survival of your business. You should not be reluctant to take legal action quickly, even if it may cost you some money to do so.

7 Pay weekly attention to your credit control

You need to know what is owed to your business every week, and who owes it.

THIS CHAPTER IN ESSENCE

1 A person may be declared insolvent by the High Court once he or she has committed an act of insolvency and his or her liabilities exceed his or her assets. Mere failure to pay a debt is not necessarily evidence of a state of insolvency.
2 Voluntary surrender is the process by which the estate of a debtor is sequestrated at his or her own request.
3 A creditor who has an unsatisfied and liquidated claim may apply to court for the sequestration of the debtor's estate. The court may grant the order, even if it is against the express wishes of the debtor. When this process is applicable to natural persons, it is known as compulsory sequestration. When it is applicable to corporations and juristic persons, it is known as liquidation.
4 Civil legal proceedings by or against the insolvent are stayed on sequestration, until such time as a trustee has been appointed.
5 The Act divests the insolvent debtor of his or her estate and vests it in a trustee.
6 On insolvency, a collective of creditors comes into existence. A creditor's sole redress now is to prove a claim against the insolvent estate for the purpose of sharing in the proceeds of that estate with all the other proven creditors.
7 The trustee must collect all assets and may take steps to set aside assailable transactions entered into by the insolvent before sequestration.
8 After the sale of the property of the insolvent estate, the trustee must distribute the proceeds among the creditors in the order of preference set out in the Act. The claims of secured creditors are met first. The remainder is known as the free residue.
9 The insolvent may not enter into any contract in which the estate is likely to be adversely affected. These contracts are not void, but voidable at the election of the trustee.

10 All the property of the solvent spouse is vested in the trustee of the insolvent estate, and the onus is on the solvent spouse to show that the property claimed is, in fact, the solvent spouse's separate property.
11 The termination of insolvency is known as rehabilitation, and has the effect of ending the sequestration and terminating all debts that were due.

QUESTIONS

Short questions (1–5 marks)

1. List eight acts of insolvency.
2. List ten things that do not fall into an insolvent estate.

Paragraph questions (5 marks)

1. What is meant by an act of insolvency?
2. Discuss what falls into an insolvent estate, and what does not.
3. What factors will the High Court consider when granting an application for voluntary surrender?
4. Discuss the effect of sequestration on the property of the spouse of the insolvent.
5. Discuss how the proceeds from the realisation of assets of an estate are applied in terms of the Insolvency Act to meet claims of creditors and costs.
6. Briefly discuss five acts of insolvency.
7. What is an assailable transaction?

Essay questions (10 marks)

1. Distinguish between voluntary surrender and compulsory sequestration.
2. Discuss the process by which persons are rendered insolvent, sequestrated, and rehabilitated.

Problem question (20 marks)

1. Jacob is a wealthy businessman who makes a lot of money from corrupt dealings with politicians. He spends R2 million on works of art, which he donates to a museum. Another R8 million is put

into his pension fund, and the remaining R30 million is given to his wife. He owes R60 million and is declared insolvent. Creditors demand to be paid. Advise the trustee.

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1 Insolvency Act 24 of 1936.

2 Ibid.

3 Gibson, 568–573; Havenga et al., 251–252; Sharrock, 600.

4 *Ex parte Van den Berg* 1962 (4) SA 402 (O).

5 *Ex parte Anthony en 'n ander en ses soortgelyke aansoeke* 2000 (4) SA 116 (C).

6 *Ex parte Oosthuysen* 1995 (2) SA 694 (T).

7 *Ex parte Goldman* 1930 WLD 158.

8 *Levin and Kagan v Berson* 1938 WLD 107.

9 Gibson, 562–568; Havenga et al., 252; Sharrock, 604–607.

10 Sharrock, 604–606.

11 Sharrock, 605–606.

12 *Mamacos v Davids* 1976 (1) SA 19 (C).

13 *Gardee v Dhanmanta Holdings and others* 1978 (1) SA 1066 (N).

14 *Mamacos v Davids* 1976 (1) SA 19 (C).

15 Ka-Mbonane, I, Unfriendly courts for ‘friendly sequestrations’? *De Rebus*, Pretoria: Law Society of South Africa, June 2006.

16 *Bevan v Bevan and Ward* 1908 TH 193.

17 *Kuhn v Karp* 1948 (4) SA 825 (T).

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Glossary

Abrogation through disuse: A law becomes so out of date that it becomes irrelevant.

Absolute defences: Can be raised against all holders of a cheque, including a holder in due course.

Acceptance: The express or implied signification by the offeree of his or her intention to be bound contractually in terms of the offer made.

Access to justice: Being able to claim rights and enforce obligations in our justice system.

Accommodation party: A person who signs a negotiable instrument as drawer or maker, acceptor or indorser without receiving value for it, for the purpose of lending his or her name to some other person.

Accountability: Having to report and be answerable for your policies, decisions and actions.

Accused: Person formally charged by the police with a criminal offence.

Actio injuriarum: A remedy in the law of delict for a wrong done to an interest of personality. This action relates to an injury to a person's dignity, reputation or bodily integrity.

Actio quanti minoris: A remedy under the law of sale in which the buyer sues for a reduction in the purchase price, to the true value of the damaged thing being sold in the condition at delivery, that is, the difference between the price paid and the value.

Actio redhibitoria: A remedy under the law of sale in which the buyer may sue to return the parties to their respective positions prior to the contract.

Active concealment: The failure to correct a false impression or half-truth.

Administration order: A debtor who is unable to pay his debts can apply for an administration order in a magistrate's court provided his debts do not exceed R50 000.

Advocate: A specialist legal practitioner who is instructed to take on cases by attorneys when a specialist skill is needed in a court case or research into the law.

Aesthetic design: A design applied to an article for the sake of pattern or shape, and which has features that appeal to the eye, irrespective of aesthetic quality.

Affidavit: Sworn statement made under oath.

Affirmative action: Measures to ensure that suitably qualified people from designated groups have equal employment opportunities and are equitably represented in all occupational categories and levels in the workforce of a designated employer.

Affirmative warranty: In an insurance contract, a statement of fact or current knowledge.

Agency: A contract by which the agent is authorised, and usually required, by the principal to contract or negotiate a contract on the latter's behalf with a third person.

Ambush marketing: When major public events, like rock concerts or sporting events, are targeted by sellers of products and services in order to promote their goods and services.

Anonymous partnership: A partnership in which one or more partners, by agreement, do not take an active role in the partnership business, are not disclosed to the public as being partners, and who are liable only towards their co-partners and not to creditors of the partnership.

Antenuptial contract: A contract between a couple before they get married or enter into a civil partnership.

Anticipatory breach: A party to a contract makes it known that he or she will not perform on the due date.

Appeal: A process by which a higher court may reconsider a previous judgment in the same case.

Appellant: Person noting an appeal to a higher court to consider whether an original judgment is correct based on the facts or law of the case.

Applicant: Person making an application.

Aquilian action: A remedy in the law of delict for a wrong done to an interest of substance.

Arbitration: When an independent person decides on the best and most effective way to resolve a dispute.

Assignment: Substitutes a third party for one of the parties to a contract in the capacity of both debtor and creditor.

Attorney: Legal practitioner consulted by members of the public.

Attorney-and-client-costs: The legal costs between an attorney and a client for all the work done on a case, e.g. the cost of a legal consultation.

Audit: A systematic examination of the financial and accounting records to verify the accuracy and truthfulness of the financial statements.

Aval: A surety.

Average clause: In a contract of insurance, this clause provides that the insured will bear a proportionate share of the loss to the extent that he or she is underinsured.

Balance of probabilities: Legal test to decide whether you have proved a civil case.

Bait marketing: The advertisement of goods or services that deceives consumers as to their availability.

Bank cheque: A cheque drawn by a bank on itself payable to another person.

Bar association: Association of advocates at each seat of the divisions of the High Court.

Barter: A contract where goods are exchanged for other goods.

Bearer: Any person in possession of a bill, cheque, or promissory note payable to bearer.

Beneficiary: The person for whose benefit a trust was created.

Benefit of cession of action: A defence available to a surety who has already paid according to his or her suretyship obligation.

Benefit of division: A defence where there are two or more sureties for a single debt of the principal debtor.

Benefit of excussion: A defence when a surety is sued, in which the creditor is made to first proceed against the principal debtor before claiming from the surety.

Bill of costs: The legal practitioner's account for payment by the unsuccessful litigant to a successful litigant.

Bill of exchange: An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable time, a sum in money to a specified person, or to that person's order, or to bearer.

Black Economic Empowerment: Building the capacity of and creating opportunities for people who have been historically disadvantaged through apartheid policies and laws.

Black people: Africans, coloureds and Indians.

Blank indorsement: The indorser merely places his signature on the back of an order instrument and does not indicate any indorsee to whom payment must be made.

Bona fides: In good faith.

Breach: Breaking or not following a law, code or agreement.

Bywoner: A tenant under a contract of lease where the rent consists of a certain quantity of agricultural produce.

Cambial obligation: A warranty by the drawer and each indorser that the cheque will be paid by the drawee, and that if not, the drawer or indorser will pay it.

Candidate attorney: Person with law degree serving articles of clerkship under a supervisory attorney.

Capacity: Competence in the eyes of the law to have rights and duties, perform juristic acts, incur civil or criminal liability for wrongdoing, and to be a party to litigation.

Capital: Assets and money used to start a business or invested to make money.

Casus fortuitus: Unavoidable situations, such as government actions or changes in the law.

Caveat subscriptor: Let the signer beware. This means that a person who signs a written contract is deemed to have taken notice of its contents and is bound by its terms, whether he or she has read them or not.

Cede: Legally give or transfer your rights.

Cession: The process by which one party called a cedent transfers personal rights to another party called a cessionary.

Cession *in securitatem debiti*: A form of pledge to secure a debt by effecting a cession of moveable incorporeal rights.

Cheque: An unconditional order in writing, addressed by a person to a banker, signed by the former, requiring the banker to pay on demand a sum certain in money to a specified person, or to that person's order, or to bearer.

Child: A natural person under the age of 18 years.

Circuit division of the High Court: Temporary mobile courts.

Citation of a court case: The way the name of the court case is written, printed or the case is referred to.

Civil procedure: Deals with the steps to be taken to enforce rights between legal subjects.

Claimant: Person making a claim.

Class action: When a group of affected people bring a case jointly or on behalf of a wider group of people that may benefit from the outcome.

Clerk of the magistrates' court: In charge of the administration of a magistrates' court. He or she issues legal documents such as summonses, warrants and subpoenas.

Close corporation: A juristic person endowed by the Close Corporations Act with legal personality and has powers similar to those of a company.

Closed shop agreement: Collective agreement requiring all employees to be members of the trade union.

Collection costs: Legal fees to enforce a consumer's obligations under a credit agreement

Collusive tendering: Competitors undermine the tender process by agreeing that one of them should not submit a tender, or submit a very high-priced tender so as to ensure that the other competitor wins.

Commanditarian partnership: A partnership in which, by agreement, the partnership business is carried on in the name of one or more ordinary partners, while the identities of the commanditarian partners are not disclosed to the public but only to their co-partners.

Common law: This is all law except for legislation, and consists of all the laws considered by South African courts as being persuasive or binding. It includes judicial precedent, judicial interpretation of statute, commentaries, customs, customary law and foreign law.

Common-law offences: Laws that are not made by Parliament, but have been part of our legal system for centuries, e.g. murder, rape, theft, assault, or a new law created through judicial decision by the courts.

Complainant: Person making a complaint.

Compromise: The parties, by agreement, may settle an obligation.

Compulsory sequestration: A creditor who has an unsatisfied and liquidated claim may apply to court for the sequestration of the debtor's estate.

Concursus creditorum: A collective of creditors comes into existence on a debtor's estate is sequestrated.

Conditional contract: An agreement where performance is dependent on the occurrence or non-occurrence of a future uncertain event.

Condonation: Asking to be legally excused for having to make a late application. Good reasons must be given for the late application.

Confidential: Information that is personal or private, and should not be publicly disclosed.

Conflict of interest: When there are competing interests or needs.

Consent: To agree.

Consequentialism: An approach to morals which evaluates behaviour according to the end results.

Constitutional law: This branch of law deals with the composition, authority, and functions of governmental bodies, such as the structure and functions of the State, provinces, State President, executive, legislature, and judiciary.

Constructive delivery: A fictitious process that the law accepts as equivalent to actual delivery.

Consumer: A person to whom goods and services are marketed for business reasons, or a person who enters into a transaction with a supplier.

Consumer credit information: Information usually held by a credit bureau.

Contingency fee: When legal practitioners are paid if they win a case.

Contra bonos mores: Against public policy.

Contract: A lawful agreement made by two or more persons within the limits of their contractual capacity, with the serious intention of creating a legal obligation, communicating that intention without vagueness to each other, and being of the same mind as to the subject matter, to perform positive or negative acts which are possible of performance.

Contributory negligence: The defendant admits some negligence, but also alleges that the plaintiff was negligent and that the negligence of the plaintiff contributed to the harm suffered.

Cooling-off period: Contracts may be terminated for any reason by one of the parties within a certain number of days of the agreement.

Co-operative: A voluntary association of persons who jointly own and control an enterprise run on democratic principles to meet specified collective economic goals.

Copyright: The legal right granted to an author, composer, playwright, publisher, or distributor to exclusive publication, production, sale, or distribution of a literary, musical, dramatic, or artistic work.

Corporate governance: Structures and processes with checks and balances to enable directors to discharge their legal responsibilities and to oversee compliance with legislation.

Corporation: An association of parties, created and recognised by law as a separate legal entity, in terms of which the shareholders (in the case of a company) or the members (in the case of a close corporation) generally contribute capital or skills to attain profits.

Crimen injuria: The common-law crime of wrongful, intentional and serious infringement of another person's dignity or privacy.

Criminal law: This branch of law defines what constitutes a crime and prescribes the penalties for criminal conduct.

Criminal procedure: Sets out the rules of how a criminal court operates, the powers of magistrates and judges in criminal matters, and how persons can be brought before a criminal court.

Criteria: Factors used decide something.

Crossing on a cheque: An instruction to the drawee bank to pay the cheque only to another bank.

Curator ad litem: Person appointed by the court to represent a person who lacks legal capacity, e.g. a minor child.

Curator bonis: Person appointed by the court to assist a person incapable of managing his or her own affairs.

Custom: A community does things in a particular way.

Damages: Legal compensation for injury or harm caused by someone's unlawful actions.

De bonis propriis: An order as to costs that must be paid by the legal representative personally.

Debt counsellor: A natural person registered with the National Credit Regulator offering a service of debt counselling to an over-indebted consumer.

Deemed: Regarded or treated as by a law, policy or procedure, e.g. the beneficiary of a trust is deemed to own the assets of the trust.

Defamation: The unlawful, intentional publication of words or conduct referring to the plaintiff, which tends to lower the esteem of the plaintiff in the minds of right-thinking persons.

Default judgment: Judgment taken against someone in court when they do not arrive or have not responded to a claim.

Defendant: A person who has to answer a claim in a civil case.

Delegation: Substituting a third party for one of the parties to a contract in the capacity of debtor.

Delagatus non potest delegare: A person to whom something has been delegated may not delegate to someone else or employ a sub-agent without permission.

Delict: The wrongful act or omission of a person which causes loss to another.

Deontologicalism: An approach to ethics that requires a person to do the right thing regardless of the consequences.

Designated groups: Black people, women, and people with disabilities who are citizens of South Africa by birth, descent or by naturalisation.

Designed concealment: A person purposefully conceals information he or she has a duty to disclose.

Disbursements: Expenses of a legal practitioner in a case, e.g. telephone calls, photocopies.

Discretion: When you have the power to do or not to do something. The exercise of a discretion must be reasonable and lawful.

Dishonour: The person or institution who should have paid on the negotiable instrument refuses to do so.

District magistrates' court: Deal with less serious criminal cases and civil claims of up to R100 000. A district magistrates' court can impose a maximum criminal sentence of up to three years' imprisonment or a fine of up to R60 000.

Doctrine of constructive notice: A person contracting or dealing with a company is deemed to be aware of the contents of the company's Memorandum of Incorporation.

Doctrine of precedent: The authority given to past decisions of courts.

Doctrine of the undisclosed principal: An agent must disclose to the third party that he or she acts on behalf of a principal. If not, the third party may be entitled to hold either the principal or the agent liable.

Doctrine of valuable consideration: A contract is not valid unless the other party gives, promises, or does something in return.

Domicilium citandi et executandi: Official address for receiving all legal documents.

Dominant impression test: Used to determine whether someone is an employee or an independent contractor.

Dominant position in a market: If a firm has at least 45 per cent of that market; or over 35 per cent of that market and is unable to prove that it does not have market power (the ability to control prices, exclude competition, or behave to an appreciable extent independently of its competitors, customers, or suppliers); or it has less than 35 per cent of that market and has market power.

Drawee: The person to whom the order/instruction to pay is addressed.

Drawer: The person who gives the written order/instruction in a bill of exchange or in a cheque that a sum of money must be paid.

Due process: An independent, unbiased judiciary must apply the law.

Duress: A situation in which a person suing was induced by violence, threat, or fear to do something.

Duty of disclosure: The insured must answer questions put to him or her in the proposal form both truthfully and accurately, and is obliged to volunteer knowledge material to the risk.

Emancipation: A guardian may grant a minor permission to control his or her own trade, business, or professional affairs. Permission may be granted to a lesser or greater extent.

Enforce: Legally implementing or making effective.

Entitled to: Have a right to, e.g. when you are entitled to legal aid under the Constitution.

Equality court: The name given to a magistrates' court when it hears a case under the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000.

Essential terms of contract: The characteristic key terms that must be agreed on for the particular type of agreement to be held effective and binding. These terms may sometimes be called *essentialia.*

Estoppel: A person is prevented from denying the truth of a representation previously made by him or her (intentionally or negligently) to another person if that person, believing it to be true, acted on this representation to their prejudice.

Ethics: The application of moral or ethical norms to business.

***Ex post facto**:* Authority is given after the fact.

Exceptio non adimpleti contractus: A defence when being sued for breach of a contract. Where one party has not fully performed their obligations under a contract, and sues the other for their performance, the plaintiff will be met with the defence that he or she must perform first before requiring the other party to perform.

Exception: Something that does not follow a general rule, policy or procedure.

Excess clause: In a contract of indemnity insurance, this clause holds the insured liable on the first portion of any claim. This is the uninsured portion of any claim.

Executive: The president, deputy president and ministers.

Exempt: When you are excused from doing something, e.g. legal aid documents are exempt from stamp duty.

Expedition theory: When the offeree posts the letter of acceptance.

Ex turpi causa non oritur actio: An illegal contract can never be enforced, irrespective of whether the plaintiff knew of the illegality.

Express: Specifically stated or set out, e.g. in a law or policy.

Expropriation: The State, or a provincial or local authority, forces the sale of land required for public projects or mineral exploration.

Extraordinary partnership: The liability of certain partners is expressly limited.

Fact that is material to the risk: In an insurance contract, every circumstance that a reasonable person might suppose could in any way influence the insurer in considering whether it will enter into the contract at all, and on deciding the terms of the contract, such as the amount of the premium.

False material statement of praise or *dictum et promissum*: A false statement made by the seller during negotiations before the contract is entered into.

Forfeiture clause: In a contract of insurance, this clause provides that the insurer can avoid all liability in the event of any fraudulent misrepresentation by the insured.

Formality: A process or formal step that must be complied with or observed for the validity of certain contracts.

Franchise: An agreement in which a franchisor grants a franchisee the right to carry on business within a specific part of South Africa. In exchange for payment, the franchisee is allowed to use a system or marketing plan that is controlled by the franchisor.

Fraudulent misrepresentation: The representation of a false fact, made fraudulently, that was believed by the representee and was one of the factors inducing him or her to contract.

Fronting practice: A transaction, arrangement or conduct that directly or indirectly undermines the objectives of the Broad-Based Black Economic Empowerment Act.

Fulfilled: Achieved, implemented or satisfied, e.g. when your rights to things like equality and human dignity under our Constitution are fulfilled.

Functional design: A design applied to an article with features that are necessitated by the function to be performed by the article. It also includes the circuitry of integrated electrical circuits.

Generally Accepted Accounting Practice (GAAP): A widely accepted set of rules, conventions, standards and procedures for reporting financial information.

Good faith: Something done honestly, whether negligently or not.

Good standing: Being allowed to practise professionally by the relevant law societies, e.g. instructing a legal practitioner who is in good standing.

Government Gazette: A newspaper issued by the State.

Guardian: A person who may enter into certain contracts on behalf of another person (usually a minor) regarding his or her maintenance and estate.

Hacking: The unauthorised access to and tampering with data messages, and also computer-related extortion, fraud and forgery.

Holder: The payee or indorsee of a negotiable instrument who is in possession of it, or who is the bearer of it.

Houses of Parliament: The National Assembly and the National Council of Provinces.

Huur gaat voor koop: The sale of the leased property does not prejudice the tenant, since the buyer at the time of the sale had actual, or constructive, notice of the lease. The new owner simply steps into the shoes of the original landlord.

Implied: Not stated in words, but may be implied by law or from the surrounding circumstances at the time.

In pari delicto potior est conditio possidentis: Where both contracting parties are equally at fault, the performing party cannot claim back what he or she has paid to, given to, or done for, the other party.

Incidental terms of contract: These terms may be included specifically into a contract by the parties for their own convenience.

Incontestability clause: In a contract of insurance, this clause provides that after a certain period, the insurer may not avoid a claim because of any misrepresentation, fraud, or any material fact.

Incorporation: The process by which a company is formed. The company will come into existence on the date it is registered officially.

Indemnify: An agreement to compensate another person if he or she suffers financial loss from a specified cause.

Indemnity insurance: The insurer undertakes to compensate the insured for an actual loss he or she may suffer in future. The event may never occur, and the amount the insurer will pay is uncertain at the time the policy is issued.

Independent contractor: Undertakes to perform a certain job, but does not operate under the control and supervision of the employer.

Indorsee: The person who is specified in an order instrument as the person entitled to payment, may in turn, give instructions that another person must receive payment.

Indorsement: The signature the holder places on the back of an order instrument when he or she wishes to negotiate (transfer) the instrument which is in his or her possession, to another person.

Indorser: The person entitled to payment of an order instrument, may in turn, give instructions as to whom payment must rather be made.

Inferior courts: All magistrates' courts and small claims courts; also known as lower courts.

Information theory: When the letter of acceptance reaches the mind of the offeror. This means that acceptance happens when the letter is read.

Insider trading: The illegal buying or selling of securities on the basis of information that is unavailable to the public.

Insolvency: A declaration by the High Court that a person has committed an act of insolvency, and liabilities exceed assets.

Instituting action: Starting a legal action.

Insurable interest: Where a person can show that he or she stands to lose something of an appreciable commercial value by the destruction of the thing insured.

Insurance: A contract between an insurer and an insured, by which the insurer undertakes, in return for the payment of a price, to give the insured a sum of money or its equivalent, on the occurrence of a specified uncertain event in which the insured has some interest.

Intellectual property law: Regulates the creation and utilisation of immaterial property and the enforcement of resultant rights. The objects of the various rights typically include patents, copyright, merchandise marks, registered designs, and trade marks.

Interdict: A court order instructing someone to do something or to stop doing something.

Interim: In the meantime – something that is temporary, e.g. an interim court order.

Interlocutory application: An application to do something that is a step to the next necessary stage in the legal process, e.g. applying for condonation for a late application for leave to appeal.

Intermediate credit agreement: A credit facility where the credit limit is above R15 000 or a credit transaction where the principal debt is between R15 000 and R250 000.

Interpretation of contracts: Courts first look at the language used, then the circumstances in which the contract was made, and finally they apply particular rules of interpretation to help them understand the meaning intended by the parties.

Ius civile: Roman law that applied only to Roman citizens.

Ius gentium: Roman law that applied only to non-Roman citizens.

Joint and several liability: Liability imposed by law or by agreement on two or more debtors, both jointly and severally, with the result that the creditor can claim the full

amount of the debt from any of the debtors, and the debtor so paying is then entitled to reclaim their proportionate share of the debt from each of the other debtors.

Joint liability: Liability shared by two or more debtors, where each is liable only for his or her proportionate share of the debt.

Joint venture: An association of persons, natural or juristic, who agree to engage in a common undertaking by combining selected property and expertise resources, without forming a partnership or corporation.

Judicial precedent: The body of law resulting from decisions on points of law made by other courts with regard to the same circumstances.

Jurisdiction: The authority that a court has to decide a matter before it.

Juristic person: Non-living association which is given the capacity for rights and duties by the law, e.g. corporation.

Justa causa: Provided that an agreement is made for a good reason that is seriously intended by the parties to be binding on them, it is enforceable under South African law.

Justice: The general sense of people of goodwill as to what is fair and right.

Justinian: Roman emperor who consolidated Roman law into the Code of Civil Law or Corpus Juris Civilis.

Kustingbrief: A special mortgage over immovable property made in favour of the seller of that property, for a part of the price that the buyer is allowed to retain on loan, or in favour of other persons, for monies lent by them to the buyer in order to enable the buyer to pay the price of the property mortgaged.

Large credit agreement: A credit transaction where the principal debt under that transaction is at or above R250 000.

Latent defect: A fault with the thing being sold that is not apparent to an ordinary person, even if it would be apparent to an expert.

Law: Law is defined as the body of rules governing human conduct, recognised as binding by people and enforced by the State.

Law of evidence: Sets out how facts must be proved in a criminal or civil court case.

Law Society: An association for attorneys in each of the provinces. A practising attorney must by law be a member of at least one of these societies, which seek to promote the interests of the profession and maintain ethical conduct.

Lay-by: An agreement the consumer will pay instalments while the supplier holds the goods until the full price is paid.

Lease: A contract between two persons, the landlord and the tenant, for the letting and hiring of specified immovable property, in terms of which the landlord grants the temporary use and occupation of the property to the tenant for a period in time in return for a specific sum of money (or a share in the proceeds or fruits of the property) called rent.

Leave to appeal: Legal permission to appeal against a judgment or sentence in a case.

Legal capacity: By law able to have rights and duties.

Legal personality: A personality under the law, e.g. a company, a close corporation, an association, a trust.

Legal practitioner: An attorney or advocate.

Legal precedent: A case or court judgment that sets the law that other cases must follow.

Legal standing: The capacity to litigate.

Legal subject: Any person, or entity, who can hold rights and duties in terms of the law.

Legislation: The setting down of binding rules of law in a formalised way, by an authority that has the legal capacity to do so.

Lex commissoria: This type of forfeiture clause allows a creditor to keep what was received from a debtor if the agreement is cancelled.

Liable: Legally responsible for something, e.g. owing money.

Liabilities: What you must pay others, e.g. your debts.

Lien: The right acquired by a person who is in possession of someone else's property until he or she is refunded for expenditure on the article, or paid for his or her labour in respect of the article.

Limited liability: The liability of a shareholder of a company is limited either to the amount unpaid on shares held by that shareholder, or to an amount that that shareholder may have undertaken to contribute to the assets of the company in the event of it being wound up.

Limping contract: Unequal situation where an innocent minor can choose whether to enforce an unassisted contract or cancel it. The other party is denied this choice and must abide by the decision of the minor.

Liquidation: Process by which the High Court declares a juristic person insolvent.

Listed company: A company that has fulfilled the listing requirements of a stock exchange and whose shares are quoted on, and can be bought and sold on that stock exchange.

Litigant: Person who is one of the parties or sides in a court case.

Litigation: Taking legal action through a judicial process, normally a court.

Lock-out: A form of industrial action by an employer where employees are physically excluded from the workplace until they agree on the terms and conditions proposed by the employer.

Major or adult: A natural person who is 18 years of age or older and has full contractual capacity and legal standing.

Mala fides: In bad faith.

Market sharing: Two or more competitors divide markets by allocating customers, suppliers, territories or specific types of goods or services.

Marking on a cheque: A drawer or indorser of a cheque may add words that restrict or exclude the ability of a holder to negotiate it.

Master of the High Court: Responsible for the control of the administration of the estates of minors, insane persons, insolvent persons, and deceased estates.

Matter: Case, dispute or issue that can be taken to court.

Mediation: A process in which a neutral person facilitates communication between people in a dispute to help them reach a mutually acceptable agreement.

Merger: When the qualities of debtor and creditor coincide in the same person in respect of the same obligation; or the direct or indirect acquisition or establishment of control by one or more firms over the whole or part of the business of another firm.

Merx: The thing being sold.

Metatag: A descriptive keyword inserted in the source code of a website to enable internet search engines to identify a particular site.

Minimum resale price maintenance: When the supplier or producer of an item dictates to its distributor or retailer the price at which is must on-sell the product to third parties.

Minor: An unmarried child, i.e. a natural person under the age of 18 years who is not married.

Misappropriation of advertising value: Consumers are mislead into thinking that a product or service is associated with another that is advertised.

Misrepresentation: False representation of a past or present fact.

Mistake: A misapprehension of the existence or non-existence of a fact or a statement of facts.

Mora creditoris: Where the creditor unjustifiably refuses or delays assistance as required and this obstruction prevents the debtor from performing in terms of the contract.

Mora debitoris: Where there is wrongful late performance or failure to perform the contract within the proper time, the debtor is in default.

Mora ex persona: Debtor fails to perform his or her obligations under a contract within a reasonable time.

Mora ex re: Where a time period for performance is specified in the contract and the debtor fails to perform within that time, the debtor is automatically in default.

Mortgage: The real right of one person called the mortgagee over the property of another person, the mortgagor, as security for the payment of a debt. The property must be in the form of an immovable asset or assets.

Mortgage bond: The name of the document which is registered to create a mortgage.

Motion proceedings: Where there is no dispute of fact (that is, the facts are agreed but there is a dispute of law), then an applicant can start motion proceedings and evidence is given by affidavit.

Natural person: A human being.

Negative option marketing: A promotion or inducement by the supplier that the consumer will accept goods or services automatically in future, unless the consumer refuses the offer or inducement.

Negotiable instrument: A document that contains a promise that the person in possession of the document (the holder) will be paid a specified amount of money.

***Negotiorum gestor* or manager without authorisation**: A person who undertakes the business of another without the authority of the latter and in the latter's absence, with the sole object of benefiting the other person and with the intention of recovering his or her expenses.

***Nemo plus juris* rule**: One cannot transfer better rights to another person than the rights that you have yourself.

Non-compliance: Not following or obeying a law, policy, procedure or contract.

Non-indemnity insurance: The insurer undertakes to pay an agreed specified amount on the occurrence of a certain event. The amount payable is not related to the extent of loss suffered. The amount is determined at the time the policy is issued.

Non-litigious: Matters or issues that do not go to court, but may be solved in other ways.

Non-profit company: Owned by members, and incorporated for a public benefit or a purpose related to social or cultural activities, or communal or group interests.

Notarial bond: A form of mortgage over movable assets.

Obiter dicta: Remarks made in passing in a court judgment.

Obligations: Legal duties.

Offer: A proposal that expresses a person's willingness to become a party to a contract, to comply with the terms expressed, and to be bound contractually if another person accepts.

Onus: Legal duty or responsibility, e.g. the prosecutor's onus of proving an accused guilty.

Option: An agreement in terms of which the person granting the option agrees to keep an offer open to someone else for a specific time.

Oral argument: Verbal argument in court or another forum.

Ordinary resolution: A resolution passed by at least 50 per cent of the voting rights exercised on the resolution.

Organisational reputation: The way the character of an organisation is seen.

Pacta sunt servanda: The recognition of the sovereignty of states and the obligation to respect agreements between sovereign states.

Paralegal: Person who is not a legal practitioner, but who has legal knowledge, skills and experience.

Parol evidence rule: A rule of evidence which also may be used by the court to work out the intention of the parties. Where the court is interpreting a written document, no oral evidence will be allowed if it contradicts or changes the written terms. Similarly, where the terms of a written contract are clear and unambiguous, no evidence may be given to vary their plain meaning.

Partnership: A contract between at least two persons, in which they all agree to contribute money, labour, or skill in a common stock, and to carry on business with the object of making a profit for their joint benefit.

Party: Person or side involved in a legal case.

Party-and-party-costs: Costs between the opposing parties or sides in a legal case, e.g. paying for the time spent by the other side's legal practitioner if costs are awarded against you in a case.

Passing off: The situation where one person disguises their goods as that of another person by using misleading names, marks, or descriptions.

Patent: An exclusive right granted for an invention, which is a product or a process that provides a new way of doing something, or offers a new technical solution to a problem.

Payee: The person to whom payment must be made.

Penal jurisdiction: The court's power to sentence in cases involving crimes, e.g. drug-dealing, drunken driving.

Pending: Waiting for or until something happens, e.g. pending a court date or judgment.

Perfecta: A stage in a contract of sale when the contract is complete and the risk passes to the buyer.

Perpetual succession: A corporation continues to exist until it is wound up or dissolved, even if all the original members of the corporation have changed or ceased to exist.

Personal liability company: Profit company where the directors and past directors are jointly and severally liable with the company for its debts.

Personal right: A right you hold against a specific person, e.g. someone who owes you a debt.

Personal security: A person other than the debtor holds himself or herself liable for the debt.

Placaat of the Estates of Holland of 1658: An edict in terms of which a tenant may remove useful improvements made to the premises or claim compensation for them in respect of leases over rural property.

Plaintiff: Person making a claim in a civil case.

Plea: Saying whether you are guilty or not guilty in a criminal case, or what your defence is in a civil claim against you.

Pledge: A contract by which a debtor places movable property in the hands of a creditor as security for a debt.

Power of attorney: A formal document in writing, setting out the scope of the agent's authority, and signed by the principal.

Praetor's Edict: Roman law proclamation which provides that a hotel is liable if the property of its guests is stolen or damaged.

Pre-incorporation contract: A contract entered into by someone acting on behalf of a company to be incorporated. Once this is done, the company may ratify the contract or not.

Prejudice: Unfairly or negatively affect.

Prescription: Legal time-limit before a case falls away.

Pretium: Purchase price in a contract of sale.

Price fixing: Competitors agree to directly or indirectly fix prices, discounts, credit terms, or other price and volume-related trading conditions.

Prima facie: On the face of it, whether you have a strong enough case or evidence in a case.

Principal: The party on whose behalf an agent acts.

Private company: Profit company whose Memorandum of Incorporation prohibits the sale of its securities to the public, and restricts the transferability of its securities. This type of company can have any number of shareholders.

Privilege: Information that is private between a client and legal practitioner.

Procedural law: Regulates how legal rules are applied and enforced.

Prodigal: A person who, through a defect of character or will, squanders his or her assets with such abandon that it threatens to reduce that person or his or her dependants to destitution.

Profit company: Incorporated by one or more persons for the purpose of financial gain for its shareholders. It may be a private company; public company; State-owned company; or a personal liability company.

Promissory note: An unconditional promise in writing made by one person to another, signed by the maker, and engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money, to a specified person, or to that person's order, or to bearer.

Promissory warranty: In an insurance contract, an undertaking by the insured pertaining to his or her future conduct during the period of the policy.

Proposer: Applicant for insurance cover.

Prospects of success: The chances of success in a case.

Prospectus: An invitation or advertisement offering securities to the public for subscription.

Provisional sentence proceedings: Where a plaintiff wants to sue on the basis of a liquid document.

Proxy: A person who is duly authorised to represent another at a meeting where that other can not attend.

Public company: Profit company that is not a private company, State-owned company or a personal liability company.

Pupil advocate: Person with legal degree serving pupillage under a supervising advocate.

Quantitative jurisdiction: The court's power to decide claims up to a certain amount of money.

Quantum: The amount of a claim for money.

Ratification: A contract entered into by someone without the required authority, can be confirmed subsequently by someone with the required authority.

Ratio decidendi: The legal principle of each case.

Real right: A right that you hold in a thing.

Real security: Where a particular asset belonging to the debtor is earmarked for the satisfaction of the creditor's claim.

Rear-surety or *agterborg*: A person who acts as a surety for a surety.

Regional magistrates' court: Deals with serious criminal cases, civil cases involving claims of between R100 000 and R300 000, and divorces. A regional magistrates' court can impose a maximum criminal sentence of up to 15 years' imprisonment or a fine of up to R300 000.

Registrar of the High Court: In charge of the administration and running of that division. He or she also issues legal documents such as summonses, warrants and subpoenas. Other important duties of the registrar are that of taxing-master for that particular High Court division. Registrars also compile case lists and arrange available courts.

Rehabilitation: Ends the sequestration and terminates all debts that were due.

Relative defences: May be raised against any holder of a cheque, except a holder in due course.

Relativism: An approach to ethics that suggests moral values are relative to a particular environment.

Remedy: Legal relief or help, e.g. receiving damages as compensation for injuries, getting a decision against you reviewed and changed.

Representation: A statement made by one party to another, before or at the time of contracting that induces the contract but does not become a term of the contract.

Repudiation: The refusal by one party, either in words or by conduct expressly or by implication, to carry out his or her obligations under a contract.

Rescission: A special application to court to have a judgment cancelled.

Resile: To cancel or pull out of an agreement.

Resolutive condition: Performance of a contract must be carried out until the condition is fulfilled.

Respondent: The person answering an application in a civil case, or an appeal in a civil or criminal case.

Restitutio in integrum: Restitution to the pre-contractual position.

Restraint of trade: An agreement in which a person agrees to a future limitation on his or her trade or work.

Restrictive vertical practice: An agreement between a firm and its suppliers, or a firm and its customers, that has the effect of substantially preventing or lessening competition in a market, unless a party can prove that the technological, efficiency, or other pro-competitive gain resulting from it outweighs the effect.

Review: When a higher court considers a decision made by a lower court or another body to see if it is correct and followed set procedures.

Right: Your ability to claim or protect something in which you have a legal interest from another person.

Right of first refusal: A person agrees to make an offer available for acceptance first by a specific person before anyone else.

Right of possession: Seller in a contract of sale warrants that the possession of the buyer will not be interfered with or disturbed by the seller or any third party as a result of any defect in the seller's title.

Risk: The potential for any loss resulting from the accidental damage or destruction of the thing being sold.

***Rouwgeld* clause**: A contract may contain a provision entitling a party to get out of the contract on the payment of a sum of money.

Rule of law: When government and people are subject to and respect the law.

Sale: A contract in which a seller promises to deliver a thing to a buyer who agrees to pay a certain price.

Sanctity of contract: The principle that agreements freely and seriously entered into should be upheld by the courts and if necessary, enforced.

Security: When you pay into court an amount to cover costs, e.g. costs of the opposing side in a court case.

Sequestration: Process by which the High Court declares a natural person insolvent.

Set off: Balance or cancel off one amount against another.

Settlor: This person creates a trust by making a settlement of property on the trustee on terms that it should be held by the trustee for a beneficiary.

Severability: The ability to be deleted, leaving the rest of the agreement still in existence and enforceable.

Share: Represents one unit of ownership in a company.

Shareholder: A person who holds a share in a company and whose name is recorded in its share register.

Sheriff: Responsible for the service of High Court and magistrates' court documents such as summonses, notices, warrants and court orders. Sometimes the sheriff will sell property to satisfy a judgment debt, and may arrest judgment debtors.

Small claims court: Deals with matters where the claim in dispute is R12 000 or less.

Small credit agreement: All pawn transactions, or a credit facility or credit transaction where the credit limit or principal debt is at or below R15 000.

Sole proprietor: A person who conducts business under his or her own name by simply doing business, or he or she can operate under a trade name.

Solvency and liquidity test: To provide protection to creditors, the company's total assets must exceed its total liabilities and it must appear that the company will be able to pay its

debts as they became due for the next 12 months.

Spam: Unsolicited commercial communications.

Special resolution: A resolution passed by at least 75 per cent of the voting rights exercised on the resolution.

Specific performance: A court ordered remedy that requires someone to perform their obligations in terms of a contract.

Spouse: The partner of a married person, including customary and common law, as well as the civil union partner of a person in a civil union under the Civil Union Act 17 of 2006.

Stakeholders: People who have an interest in a particular issue or process.

Stare decisis et non quieta movere: To stand by decisions and do not disturb the undisturbed.

State-owned company: Profit company that is a State-owned entity or owned by a municipality.

Statute: Law passed by national or provincial parliament, e.g. an Act, Regulations under an Act.

Statutory: To do with or in laws passed by national or provincial parliaments.

Statutory body: Bodies with certain legal powers created by statute.

Statutory offences: Crimes under statute laws, e.g. corruption, squatting.

Stipulatio alteri: A contract for the benefit of a third person.

Stokvel: An informal credit-rotating association.

Strike: A form of collective industrial action with two or more people, involving a partial or complete refusal to work or the retardation or obstruction of work.

Subrogation: In a contract of indemnity insurance, the right of an insurer who has paid the insurance money to the insured party, to use the insured's name to sue the third party who caused the loss, so as to recover its money.

Summary dismissal: The immediate termination of employment without notice.

Superior court: A higher court, e.g. a High Court compared to a magistrates' court.

Supervening impossibility of performance: Impossibility arising after the contract has been concluded.

Supplier: A person who for money sells, markets, or rents goods, or who markets or provides business services.

Supreme Court of Appeal: Decides all appeals against decisions of the High Courts.

Suretyship: A form of personal security given by a debtor to a creditor in terms of which a third person undertakes to perform the obligations of the debtor if the debtor fails to do so.

Suspensive condition: Rights and duties are delayed until the specified event happens.

Tacit hypothec: The landlord has a real right of security over the movables on any leased premises without any formality or notice to the public.

Term: Describes the rights and duties that the parties to a contract have agreed to.

Terms of contract arising by operation of law: These are in the form of rights and duties owed by the parties to each other. These may be called naturalia.

Third party: An outside or independent person – in other words, someone besides the people or bodies involved on either side of a dispute.

Time-bar clause: In a contract of insurance, this clause provides that once the insurer repudiates liability for a claim, the insured has only a specified period in which to issue summons against the insurer, failing which the insurer is released from liability.

Trade description: Label on goods that states the country where the goods were manufactured, produced or adapted.

Trade mark: Any sign capable of being represented graphically for use on goods or services. It may be a device, name, signature, word, letter, numeral, shape, configuration, pattern, ornamentation, colour or container for goods.

Traditional court: An authorised African traditional leader or deputy may hear and determine civil claims arising from indigenous law and custom.

Trial proceedings: Where the issue is one of dispute of fact, a trial action must be commenced.

Trust: Legal or equitable title to property belonging to a settler is vested in a trustee for the purposes of being applied for the benefit of another, known as the beneficiary. The trustee must deal with the trust property for the benefit of the beneficiary.

Trustee: The legal owner of the property settled by the settlor.

Turquand Rule: When a third party enters into a contract with a company there is a legal presumption that all acts of the company's internal management have been properly carried out and the company will be bound to the contract even if it is proved that the necessary acts of internal management were not carried out, or were irregular or defective, or that the representative of the company had no authority to bind the company.

Uberrima fides: Utmost good faith.

Ultra vires: Where subordinate legislation goes beyond the authority it is given by the Act of Parliament.

Undisclosed principal: A principal whose existence is not disclosed to third parties who contract with the principal's agent.

Undue influence: The weakening of a person's resistance in order to make his or her will pliable.

Universal partnership: The partners intend that everything they acquire during the partnership, from all kinds of commercial ventures, shall be partnership property.

Unjustifiable enrichment: Obtaining recovery or compensation for a benefit that was received without a valid cause.

Unsolicited goods or services: Delivered without a consumer having requested them, either expressly or impliedly.

Value: A person gives value for an instrument if he or she gives or does something in return for it.

Vexatious: When a case is made without sufficient grounds with the aim of annoying or embarrassing the other side.

Vicarious liability: An employer is liable for the acts and omissions of employees acting in the course and scope of their employment or in seeking to advance the interests of the employer.

Vindication: The right of the true owner to recover possession from anyone in whose possession the property is found.

Vis major : Act of God or natural disaster.

Voetstoots: Goods are sold ‘as is,’ without the seller being liable for latent defects.

Void contract: Has a fatal flaw and has no legal existence at all.

Voidable contract: Has a flaw that entitles the aggrieved party to choose whether to treat it as valid or not.

Voluntary surrender: The estate of a debtor may be sequestrated at his or her own request, that is, he or she applies to court for the acceptance of the surrender of his or her estate.

Waive: Choosing not to exercise or use provisions or rights, e.g. waiving the need for documentary proof, waiving the right to a claim.

Warranty: A statement that becomes a term of the contract and is enforceable.

Winding-up: The process of dissolving a company and having it formally deregistered.

With reserve: There is a minimum price that can be accepted at an auction sale. Putting up the article for auction is an invitation to do business.

Without prejudice: Reserving your rights – in other words, without giving up any of your legal rights, e.g. making an offer ‘without prejudice’ to settle a dispute.

Without reserve: There is no lowest price that will be accepted at an auction sale; the item will definitely be sold to the highest bidder.

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